
Hershey Foods Corporation 1986 ANNUAL REPORT
GENUINE CHOCOLATE FLAVOR
HERSHEY'S SYRUP
NET WT. 24 OZ.
natural chocolate
Friendly
ONE HALF GALLON (1.89 LITER)
ICE CREAM
San Giorgio
ENRICHED
LINGUINE - 19
NET WT. 16 OZ.
HERSHEY'S
MILK CHOCOLATE
NET WT. 8 OZ.
1/2 LB.

1986 ANNUAL REPORT

HERSHEY FOODS CORPORATION is a major producer of chocolate, confectionery and pasta products, and operates a chain of restaurants.

Hershey has chocolate and confectionery producing facilities in Hershey, Pa., Oakdale, Calif., and Smiths Falls, Ontario, Canada, and a confectionery producing facility in Stuarts Draft, Va. In addition, the chocolate and confectionery segment includes the H. B. Reese Candy Company, with its production facility in Hershey, Pa.; Luden's, with its production facility in Reading, Pa.; and Y&S Candies, a manufacturer of licorice and licorice-type candies with plants in Lancaster, Pa., Moline, Ill., Farmington, N.M., and Montreal, Quebec, Canada.

Friendly Ice Cream Corporation, headquartered in Wilbraham, Mass., operates over 825 restaurants located primarily in the Northeast and Midwest which serve high-quality, moderately-priced menu items and specialize in ice cream, sandwiches and informal meals. The Hershey Pasta Group has pasta manufacturing facilities in Lebanon, Pa., Omaha, Neb., Louisville, Ky., Denver, Colo., Kansas City, Kan., and Fresno, Calif.

The Corporation's principal executive offices are in Hershey, Pa. The Corporation had 15,980 full-time employees and 23,502 stockholders on December 31, 1986.

EXECUTIVE OFFICES
100 Mansion Road East
Hershey, Pa. 17033

TRANSFER AGENT AND REGISTRAR
Manufacturers Hanover
Trust Company
P.O. Box 24935
Church Street Station
New York, N.Y. 10249

INDEPENDENT PUBLIC ACCOUNTANTS
Arthur Andersen & Co.
1345 Avenue of the Americas
New York, N.Y. 10105

INVESTOR RELATIONS CONTACT
James A. Edris, Director
Investor Relations
14 East Chocolate Avenue
P.O. Box 814
Hershey, Pa. 17033-0814
Phone: (717) 534-7552

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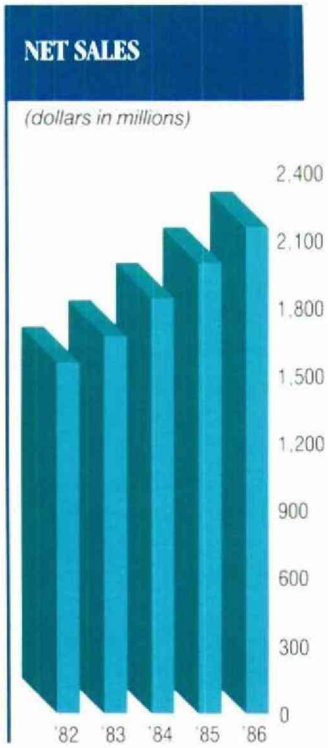
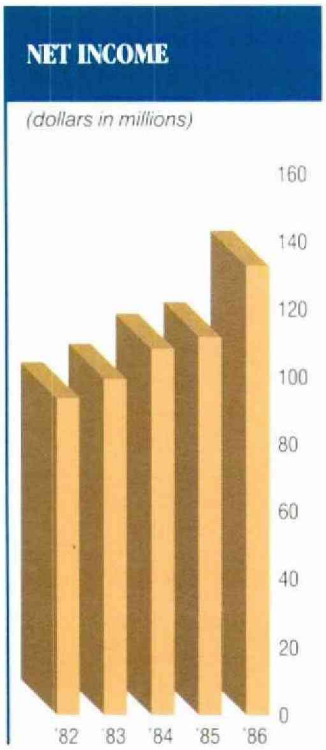
1986 FINANCIAL HIGHLIGHTS

(in thousands of dollars except shares and per share amounts)

	1986	1985	Percent Change
Net sales	**$2,169,614**	$1,996,154	+9
Income from continuing operations	**132,764**	120,649	+10
Net income	**132,764**	112,227	+18
Income from continuing operations per share	**1.42**	1.28	+11
Net income per share	**1.42**	1.19	+19
Cash dividends paid per share of Common Stock	**.5200**	.4751	+9
Cash dividends paid per share of Class B Common Stock	**.4716**	.4283	+10
Total cash dividends paid	**48,146**	43,942	+10
Capital additions	**135,828**	114,449	+19
Stockholders' equity at year-end	**727,941**	727,899	—
Price per share of Common Stock at year-end	**24.63**	17.17	+43
Stockholders' equity per share at year-end	**8.07**	7.74	+4
Outstanding shares at year-end	**90,186,336**	94,011,336	−4

All shares and per share information have been restated for the three-for-one stock split effective September 15, 1986. Total outstanding shares at December 31, 1986 of 90,186,336 consisted of 74,886,450 shares of Common Stock and 15,299,886 shares of Class B Common Stock. Income from continuing operations per share and net income per share are based on weighted average outstanding shares of 93,508,322 for 1986 and 94,011,336 for 1985. Weighted average shares outstanding and stockholders' equity reflect the purchase and retirement of 3,825,000 shares of the Corporation's Common Stock in November 1986. Stockholders' equity per share is based on outstanding shares at year-end for the applicable year.





LETTER TO STOCKHOLDERS

Hershey Foods Corporation achieved record consolidated net sales and earnings in 1986 for the eighth consecutive year. More than half of the 9-percent sales increase was attributable to volume growth as revenues surpassed the $2 billion mark for the first time in the Corporation's history. Record income from continuing operations increased 10 percent as operating margins improved in Hershey's three major divisions.

Hershey Chocolate Company sales were favorably impacted by a January price increase on the standard candy bar lines. In addition, a July weight increase on most of the standard bar lines had a positive effect on unit volume growth during the second half of the year. Although the industry-wide restaurant sales environment was weak in 1986, Friendly Ice Cream Corporation achieved reasonable sales growth through new store openings, the acquisition of several small restaurant chains and menu price increases. Hershey Pasta Group's sales improvement was derived principally from volume increases.

Each of our major divisions contributed to the increased earnings in 1986. Hershey Chocolate Company was a major factor as the January price increase and a subsequent moderation in costs led to improved margins despite the increased bar weights and significantly increased marketing expenditures. Also contributing to the improved income picture was a considerably lower net interest expense resulting primarily from a lower level of foreign borrowing.

In the fourth quarter of 1986, the Corporation adopted the Statement of Financial Accounting Standards No. 87 entitled "Employers' Accounting for Pensions," resulting in an increase in net income for 1986. This favorable effect on net income was offset, however, by the effect of the Tax Reform Act of 1986, also recorded in the fourth quarter, which retroactively eliminated investment tax credits for capital investments initiated and placed in service subsequent to December 31, 1985.

As we move into 1987 and beyond, the lower maximum corporate income tax rate provided in the Tax Reform Act will more than offset the loss of investment tax credits, and our effective tax rate will be reduced accordingly. It is difficult, however, to predict how much the bottom line will benefit for a variety of reasons, including expenditures on programs to increase sales and enhance market share.

Looking ahead, acquisitions are expected to play an important role in the growth of Hershey Foods Corporation. In describing Hershey's approach to acquisitions, it would be useful to note that we intend to build upon our strengths in the food business. These strengths include manufacturing, distribution, sales and marketing of food items, and restaurant operations. We also recognize the importance of substantial market share positions in order to compete effectively in the food business. This is increasingly important as the consolidation of the food industry continues.

Along these lines, an important event during 1986 was the October acquisition of the confectionery operations of The Dietrich Corporation, maker of LUDEN'S cough drops, 5TH AVENUE candy bar, LUDEN'S MELLOMINTS candies and QUEEN ANNE chocolate covered cherries.

Two small restaurant chains were acquired by Friendly Ice Cream Corporation during the last 12 months. Idlenot Farm Restaurants, Inc. of Springfield, Vt., consists of 12 ice cream and sandwich restaurants located in Vermont, New Hampshire and New York. Litchfield Farm Shops, Inc. of Waterbury, Conn., consists of 23 ice cream and sandwich restaurants located in Connecticut. Substantially all of these units will be converted to FRIENDLY restaurants, a move which helps to expand Friendly's presence in these important market areas on a favorable cost basis.

The Corporation's capital expenditures in 1986 totaled $136 million with the majority devoted to the construction of restaurants, the installation of manufacturing equipment, the construction of distribution facilities for existing and new products, and the completion of our Technical Center expansion in Hershey, Pa. Hershey also devoted a significant portion of its capital expenditures to maintain current facilities and to improve productivity.

Investors continued to recognize your Corporation's achievements as the value of Hershey's Common Stock increased by 43 percent during the year. The stock was split on a three-for-one basis in September. At the same time, the Corporation's dividend rate was increased, marking the 12th consecutive annual dividend increase. Hershey Common Stock holders received a 9 percent higher cash dividend payout in 1986 than in 1985.

Kenneth L. Wolfe and Richard A. Zimmerman

During November, 9,000,000 shares of Hershey Common Stock were sold by Hershey Trust Company as Trustee for Milton Hershey School, the Corporation's largest stockholder, in order to diversify its investment portfolio. Of this amount, 5,175,000 shares were sold to the public in an underwritten secondary offering. In a separate, concurrent transaction, the Corporation purchased 3,825,000 shares from the Hershey Trust, an action which should contribute to the enhancement of the total return for all our stockholders.

At the time, the Hershey Trust advised us that, subject to its fiduciary obligations, it has no intention of selling any additional shares of Common Stock and intends to maintain voting control of the Corporation.

The financing requirement for the Luden's acquisition and the purchase of Common Stock shares was met through the use of available cash resources as well as the issuance of $100 million of debt securities. Significant debt capacity remains without jeopardizing our current debt ratings.

William E. C. Dearden, former Chairman, retired from the Board of Directors on April 28, 1986. We acknowledge the valuable contributions, especially in the areas of sales, marketing and strategic planning, he made during his 29-year career with the Corporation. Joseph P. Viviano, President, Hershey Chocolate Company, was elected to the Board of Directors, effective April 28, 1986.

Throughout the year, many of Hershey's employees were involved in an examination of the Corporation's organizational structure and work activities. Their recommendations for change will result in a more productive organization with reallocation of human resources where appropriate. This commendable effort exemplifies the commitment of Hershey employees to excellence and to a stronger, more competitive organization. Their dedication is an important corporate asset.

As we reflect on 1986, it was indeed a year of major accomplishments. We recognize that dedication to the values of sound preparation, hard work and high ethical standards on the part of Hershey employees made these achievements possible. We thank them for an excellent performance and look forward to sharing the challenge of the new year in the same positive spirit.

RAZimmerman	KL Wolfe
Richard A. Zimmerman Chairman of the Board and Chief Executive Officer	Kenneth L. Wolfe President and Chief Operating Officer

Strength of established brands spurs Hershey Chocolate Company to record results

HERSHEY CHOCOLATE COMPANY

Hershey Chocolate Company again achieved record sales and operating income in 1986. Sales growth was attributable to both higher selling prices and increased unit volume. More than half of the sales gain came from increased prices, while the balance was derived from unit volume growth.

Price increases were implemented on the standard bar lines in January 1986, leading to an increase in the normal retail price from $.35 to $.40 in most outlets. In July, the Company increased weights on most standard bars and also implemented weight and price increases on the BIG BLOCK chocolate bar lines. These weight increases, most of which were in the 10- to 14-percent range, supported the Company's policy of offering the consumer consistently high quality products at the best possible value.

The increase in operating income resulted from the standard bar price increases, stable-to-lower costs for several major commodities, sales volume increases, and improved productivity and efficiencies in both the manufacturing and distribution areas. These factors offset the impact of standard bar weight increases, increased marketing expenditures and cost increases in certain raw ingredients, specifically, peanuts and almonds.

A fourth International Cocoa Agreement was negotiated in July 1986 among cocoa bean producing and consuming countries with the objective of stabilizing cocoa prices. The Agreement was ratified provisionally in January 1987, although the United States is not a party to it. Hershey's management does not expect the Agreement to have a short-term effect on the Company's cost of cocoa. Its potential long-term effect cannot be assessed at this time, although most commodities arrangements are ultimately responsive to basic supply and demand conditions of the market.

Hershey's growing share of the chocolate and confectionery market is supported by increased investment in advertising, which has more than doubled since 1980. Here, Stephen Mullen (right), Brands Manager, and Michael Riemondy (left), Assistant Brands Manager, review filming of a HERSHEY'S Miniatures chocolates television commercial with an advertising agency representative.

Hershey Chocolate Company's sales force is responsible for selling more than 40 brands of chocolate and confectionery products through over one million retail outlets throughout the U.S. Sales Representative Susan Beegle and District Manager George Prior check a store merchandising display designed to build sales through brand visibility.

The strong operating results were posted in a year which saw continued increases in competitive spending on advertising and promotions. All sectors of the Company contributed to the strong sales performance, with established products accounting for the majority of the increase. Leading the confectionery sales growth was REESE'S peanut butter cups, which continued to exhibit strength throughout the product line, including seasonal packs. HERSHEY'S milk chocolate bar and HERSHEY'S milk chocolate bar with almonds continued to show sales growth as a result of increased advertising and promotional support programs.

KIT KAT wafer bar and ROLO caramels in milk chocolate, two products manufactured and sold under license from Rowntree Mackintosh, showed strong sales increases. The Y&S Candies product line increased market share in the licorice-type candy market and continued as the leader in this category.

New products and packtypes continued to serve as a source of growth in sales. Two new products were introduced to test markets during 1986: Hershey's GRAND SLAM, a crisped rice, caramel and peanut product enrobed in chocolate, was launched in the first quarter, while Hershey's BAR NONE, a chocolate-coated, chocolate wafer product, was introduced in the third quarter.

Chocolate covered NEW TRAIL granola snack bar continued to face intense competition in the granola market, but market share was stabilized in 1986. The Company will compete in this segment in 1987 with revitalized HERSHEY'S NEW TRAIL granola snack bar packaging which strongly identifies with the HERSHEY'S brand.

The Special Markets Group successfully completed the national roll-out of GOLDEN III, a milk chocolate premium bar containing toasted coconut and butter toffee, and also introduced MARABOU MINT CRISP chocolate roll. In addition, the GOLDEN ALMOND SOLITAIRES chocolate covered almonds product line was extended to include an 11-ounce package and a 3½-ounce fund raising package. These new entries have been received enthusiastically by retailers and consumers, and initial sales have been excellent.

Hershey completed the purchase of the confectionery operations of The Dietrich Corporation in the fourth quarter of the year. The purchase included Luden's, Inc., maker of LUDEN'S cough drops, 5TH AVENUE candy bar and LUDEN'S MELLOMINTS candies, and Queen Anne Candy Company, a producer of chocolate covered cherries. These new brands are expected to contribute strong growth in the future.

Hershey remains committed to growth through acquisition. During 1986 it acquired Luden's, Inc., maker of LUDEN'S cough drops, 5TH AVENUE candy bar and LUDEN'S MELLOMINTS candies. Here, William Christ (right), Hershey Chocolate Company Vice President, Finance and Administration, and Donald Watson, Luden's Vice President, Manufacturing, inspect the new 5TH AVENUE candy bar production line at the Reading, Pa., plant.

The Company's productivity efforts continued in 1986 with the achievement of a record level of cost savings, which were primarily directed toward improved consumer value and awareness. White collar productivity improvement measures were implemented in most administrative departments during the year. These measures, combined with increased emphasis on the quality of products and services throughout the Company, have further strengthened the entire productivity effort.

The Company's philosophy of maximizing productivity and quality was inherent in all aspects of its capital spending in 1986. Expenditures focused on plant expansions, additional finished goods production lines, and increased chocolate-making capacity to accommodate both the growth of existing brands and the introduction of new products. Consistent with the direction provided by the Company's facilities planning process, investments to modernize processing and packaging equipment were continued during the year.

The strength of the Company's work force can be seen in its commitment to self-development and change. Employees from all levels logged over 50,000 hours in training programs conducted at the work site. At these programs, they learned new job skills and more about their ability to contribute to the Company's success.

HERSHEY CANADA INC.

Hershey Canada Inc. made good progress again in 1986. Sales advanced to a record high, with growth due to both higher selling prices and increased volume. Market share increases were achieved in 1986 in all major consumer product categories. However, operating income was down slightly from the previous year, primarily due to increased marketing expenditures in 1986.

These results were achieved in a difficult business environment characterized by intense competitive activity and a decline in the important confectionery and milk modifier markets in which Hershey Canada competes. The weakness in confectionery markets was attributable to higher retail prices caused primarily by the imposition of a Canadian Federal sales tax on confectionery products. This sales tax was introduced in July 1985 at a 10-percent rate. It was increased to 11 percent in January 1986 and to 12 percent in April 1986.

A 7-percent, industry-wide price increase was implemented on chocolate bars in November. This has increased the normal retail price for standard bars from \$.55 Cdn. to \$.60 Cdn. At the same time, price increases in the 5- to 6-percent range were implemented on selected grocery and licorice lines.

The 1986 sales growth was led by the chocolate category, primarily as a result of the continued strong growth of the SKOR toffee candy bar and REESE peanut butter cups. Growth was also achieved by the HERSHEY milk chocolate bar and HERSHEY milk chocolate with almond bar brands. The successful introduction in Canada of HERSHEY KISSES chocolates in September contributed to sales volume increases from new products. This chocolate volume growth in a declining market resulted in improved market share in this category for Hershey Canada in 1986.

Strong sales growth was achieved within the grocery category by BROWN COW syrup, HERSHEY'S syrup and HERSHEY'S chocolate chips. Both the BROWN COW syrup and HERSHEY'S syrup brands increased their leading market share positions within the liquid milk modifier and sundae topping categories, respectively.

Hershey's national distribution system includes two regional centers and 17 strategically located public warehouses, ensuring the efficient mass distribution of products. Managers Leonard Virbitsky (left) and James Grap use a state-of-the-art computer system to control inventories and process orders at the Company's Eastern Distribution Center in New Kingstown, Pa.

Hershey's Technical Center is responsible for the development of successful new products—essential to building market share in a highly competitive industry. Carl Wong (left), Manager, Product Development, reviews the chocolate wafer technology of BAR NONE candy bars with Dennis Eshleman, Hershey Chocolate Company Category Development Manager, at the Technical Center Pilot Plant.

Although Y&S licorice brands achieved dollar sales growth in 1986, this key business category recorded a modest volume decline during the year. These brands were adversely affected by retail price increases necessitated by the imposition of the Canadian Federal sales tax and by weight reductions.

Special Markets, which includes food service, fund raising and export sales, suffered a volume decline in 1986, although dollar sales were only marginally below the previous year. Strong sales growth by domestic food service products were offset by declines in export and fund raising sales.

Consumers expect consistently superior quality and value in Hershey's products, a reputation the Consumer Relations Department works to maintain in over 68,000 consumer contacts each year. Here, Hanna Winiger (left) and Scott Etchberger, Consumer Telephone Respondents, and Virginia McArthur, Hershey Chocolate Company Manager, Dairy Products Quality Assurance, handle consumer requests received on the new toll-free 800 telephone number.

Major capital projects in 1986 included increased licorice drying capacity at the Montreal plant and robotic scraping equipment for Y&S NIBS licorice candy production. Also, 1986 was the first year of operation for a new warehouse at the Montreal plant.

Within key commodities, a decline in the cost of cocoa beans, almonds and glucose offset increases in other commodities. Essentially stable commodity and packaging costs, coupled with productivity gains achieved throughout the year, resulted in an improved gross margin compared with 1985. The resulting higher gross profit was invested in marketing spending to support the introduction of HERSHEY KISSES chocolates in Canada, increased advertising expenditures and an expansion of Hershey Canada's part-time merchandiser sales force.

A Hershey Canada Inc. task force reviews plans for celebrating the subsidiary's 25th anniversary. Hershey Canada Inc. posted another record sales year in 1986, despite competitive pressures and a changing tax climate. Hershey Canada Inc. markets a range of chocolate, confectionery and licorice products throughout Canada.

HERSHEY INTERNATIONAL LTD.

Export sales of Hershey's products increased in the Far East and Latin America in 1986. Such increases were offset partially, however, by declining sales in the Middle Eastern markets, principally due to lower consumer buying power related to declining oil prices.

Hershey International Ltd.'s licensing ventures progressed well in 1986. HERSHEY'S milk chocolate bar, KRACKEL chocolate bar and HERSHEY'S Miniatures chocolate bars were distributed widely for sale throughout Korea under a licensing agreement with Hai-Tai Confectionery Company. The licensing venture with Fujiya Confectionery Co., Ltd. for HERSHEY'S syrup in Japan continued to expand in 1986. Discussions with respect to licensing opportunities in other key markets were initiated.

Joint venture operations in Mexico and the Philippines were profitable despite the difficult economic environments in both countries. In Mexico, new production capacity was added for HERSHEY'S KISSES chocolates, which are becoming one of Mexico's most popular chocolate products.

AB Marabou, Hershey's 20-percent-owned affiliate in Sweden, substantially improved its earnings in 1986 over 1985. Sales of its chocolate, biscuit and snack divisions were in line with expectations.

Friendly achieves record results in face of difficult industry conditions

FRIENDLY ICE CREAM CORPORATION

Record sales and operating income for Friendly Ice Cream Corporation were achieved despite heightened competition and a lack of real sales growth in the restaurant industry. Industry-wide sales reflected weaker customer counts caused by slower growth in disposable consumer income. Sales were also adversely affected by prices of restaurant meals rising faster than grocery store prices and by competition for the consumer's discretionary dollar by the durable goods sector.

The improvement in Friendly's sales over 1985 is attributable primarily to the construction and acquisition of additional restaurants, the introduction of new or enhanced product offerings and menu price increases. Approximately two-thirds of the sales gain came from new and acquired restaurants.

Friendly's sales growth resulted in market share stability in its operating regions despite heavy competitive activity. Major competitors continued to open new units and introduce new menu items. Friendly maintained market share in the lunch period of the day, but lost some ground at the dinner meal due to this increased competition. However, the breakfast and snack periods exceeded expectations and countered the adverse, industry-wide trend in these segments of the restaurant day.

Friendly has added over 150 new restaurants since 1984, achieving growth through acquisitions, restaurant construction in established markets, and expansion into new regions. One new area is Orlando, Fla., where Beverly Perkins, Restaurant Manager, and Ron McNichol, District Manager, meet outside the Division's largest restaurant.

Friendly's entry into a new market is supported by a wide range of community relations activities. One example is the Friendly Readers Program, now helping to publicize the Division's introduction into Florida. Here, Bruce Wallace, District Manager, shares a book with Matt Knox, which will be given in his name to the Longwood Elementary School library in Orlando.

Friendly's overall cost of food and supplies remained relatively stable in 1986, with some food items reflecting costs at or below 1985 levels. A severe shortage of restaurant workers in most operating areas continued unabated in 1986. Thus, employee turnover remained high and operating margins were adversely impacted as the additional costs to attract, train and retain a competent restaurant labor force continued to increase dramatically.

The exceptionally low rate of unemployment in many of Friendly's New England markets is the primary reason for the shortage of restaurant workers. The declining number of teenagers in the population has made the problem even more severe. This problem was addressed in 1986 by raising pay scales, increasing recruiting activities and devoting more time and attention to the training of new employees. In 1987, there will be continued pressure to advance pay scales and expand employee benefits. Additional recruiting efforts, particularly with working mothers, senior citizens and other non-teenage populations, will continue at an increased pace.

Friendly has also intensified its efforts to provide programs that will qualify employees more quickly and more effectively. "FASTrack to Excellence," a crew training program introduced at 250 restaurants in 1985, was implemented throughout the rest of the chain in 1986. FASTrack continues to reduce significantly the time it takes to qualify new employees.

"Video Based Crew Training," a second-generation improvement in FASTrack, produces video tapes that teach employees basic job skills. This program was introduced at over 100 restaurants during 1986. The video format focuses on critical topics such as customer satisfaction, provides a standard message to all employees, and frees the trainer to more directly assist in customer service. This program will be extended throughout the rest of the chain during 1987 and 1988.

In 1986, 49 new FRIENDLY restaurants were opened, including 42 freestanding units, with the balance located in shopping centers. Ten units were closed. In addition to the chains acquired in 1986, of which one unit was converted to a FRIENDLY restaurant, six of the 49 new units were previously operated by other companies, and were acquired and converted to the Friendly operating format on financially attractive terms.

New market development activities in Orlando, Fla., progressed, with 12 restaurants operating at the end of 1986 and six additional units planned to open during 1987. Sales results have exceeded expectations and research has confirmed that Florida residents are very receptive to the Friendly concept. Several promotional vehicles and innovative public relations programs are being tested in this market to encourage customer trial and repeat visits, building a strong foundation for future years. Included in the new openings in Orlando was an expanded, special-design restaurant constructed on International Drive, a prime tourist area near Sea World. With 184 seats, this unit is the largest that Friendly has ever operated.

Friendly's program to acquire competitive restaurants for conversion to the Friendly concept continued in 1986 with the acquisition of two small restaurant chains, in addition to selected individual site locations.

In July, Friendly acquired Idlenot Farm Restaurants, Inc. of Springfield, Vt., which operates 12 ice cream and sandwich restaurants, seven under the IDLENOT name in Vermont and New Hampshire, and five under the FLAVORLAND name in upstate New York. Friendly expects to convert 11 of the 12 units to the Friendly concept and to dispose of the remaining one. During 1986, one unit was converted, and its sales have increased significantly versus the prior year.

In December, Friendly acquired Litchfield Farm Shops, Inc. of Waterbury, Conn., which operates 23 ice cream and sandwich restaurants in the state of Connecticut. Friendly expects to convert 17 to the Friendly concept and to dispose of the remaining six.

Increased sales in 1986 occurred both in the food and ice cream product lines of the business. In the food segment, new menu offerings tended to emphasize the "Lighter Side," which is comprised of non-beef, non-fried items. The chicken salad platter and sandwich were highly successful new product introductions, adding increased variety and appeal to this portion of the menu.

The introduction of a new breakfast menu in early 1986 resulted in an improvement in breakfast sales that had been eroding in 1985 due to competitive product introductions.

Friendly television advertising and promotion efforts during 1986 focused on lunch and dinner and promoted reduced-price ice cream desserts with the sirloin steak burger and "Lighter Side" items.

Non-traditional locations, including hospitals and museums, provide Friendly with continued growth opportunities in established markets. The Friendly location at the Boston Museum of Science, which serves an average 2,000 customers each day, is just one example. Here, Carl Scheffy, Restaurant Manager, meets with a museum official.

Friendly's Research and Development group works to keep the Division one step ahead of changing consumer wants and needs. Frank Boucher, Test Program Administrator, and Noreen Carroll, Associate Food Technologist, test new menu items at the Division's Wilbraham, Mass., Test Kitchens.

Friendly achieved in-restaurant ice cream sales gains despite a major industry decline caused by a cool and very wet summer in the Northeast. The HAPPY ENDING dessert and regular ice cream sundaes were major contributors to ice cream sales increases, due in part to the introduction of the Piña Colada flavor line and to the promotion of sundaes with meals. The Waffle Sundae, the Black Forest Sundae and the Brownie Sundae were new sundae introductions in 1986.

The FRIENDLY prepackaged ice cream line includes pies, cakes, rolls and half-gallons for take-home consumption. New pie flavors in 1986 included Strawberry Cheesecake, Pecan Pie and Black Forest Cherry. During 1986, a major new product, the Sundae Snack Cup, was introduced. These new single-serve, prepackaged ice cream sundaes are topped with Hershey candies, including REESE'S PIECES candy, REESE'S peanut butter cups and MR. GOODBAR chocolate bars. Sales during 1986 exceeded expectations as the product met the consumer's desire for convenience and quality. Friendly is planning to extend the line further in 1987.

Other promotion efforts included the 99¢ Kid's Specials and various ice cream sundaes, all of which were received enthusiastically by consumers. Friendly is testing other promotion efforts, including a "senior" discount in some markets.

Friendly is also testing an "Express Lunch" concept to meet the growing, industry-wide need for speedy service during this period of the day. Preliminary results indicate consumer acceptance of this new strategy which does not compromise Friendly's quality standards.

Other testing in various stages of development includes enhancement of the breakfast and dinner offerings and development of drive-thru capabilities in certain restaurants. Friendly continues to track consumer desires and preferences, aware that it must satisfy consumer needs without detracting from its strong image as a family restaurant with courteous, friendly service at reasonable prices.

AMERICAN BEAUTY brand leads Hershey Pasta Group to record sales and earnings

HERSHEY PASTA GROUP

Hershey Pasta Group achieved record sales and earnings for the eighth consecutive year in 1986. Sales growth was attributable primarily to volume growth. Operating margins continued to improve as a result of sales volume increases, lower commodity costs and productivity programs.

The United States pasta industry enjoyed one of the highest tonnage growth rates of the last decade in 1986. This was attributable to more aggressive industry promotion and continued growth of the consumer love affair with pasta products.

The European Economic Community (E.E.C.) subsidization of Italian pasta exported to the United States continued to be a major issue in 1986. Tariffs of up to 40 percent on non-egg-containing pasta, imposed by the United States in late 1985, were removed in August 1986 in an effort to reach a settlement with the E.E.C. on citrus products. Removal of the tariffs has again provided the Italian imports with a distinct cost advantage over domestic producers, and the E.E.C. subsidy continues in violation of established international trade agreements.

While pasta industry consolidation continued during 1986, the Hershey Pasta Group maintained its national share of supermarket sales at approximately 17 percent while enjoying substantial sales growth among mass merchandisers and other non-traditional outlets for pasta. The performance of the AMERICAN BEAUTY pasta brand, which was acquired in late 1984, was particularly gratifying. The brand was introduced successfully in the Pacific Northwest and expanded its distribution in the large southern California market.

New products and new marketing programs also played a key role in maintaining the sales momentum of the Group's brands. Vegetable-flavored products for the LIGHT 'N FLUFFY, SKINNER and AMERICAN BEAUTY brands were introduced. The LIGHT 'N FLUFFY brand continued to be

Hershey Pasta Group's successful advertising campaigns build upon consumer loyalty to its six individual pasta brands—essential to success in a highly regionalized marketplace. Here, Hershey Pasta Group marketing personnel tailor a major advertising program to the Group's individual brands.

A highly motivated sales force ensures that meeting customer needs, including order placement and product promotion, is a high priority. Here, James Trebilcock, Territory Sales Manager, and Dominic Lacava, Sales Representative, arrange SAN GIORGIO pasta packages and point-of-sale materials at a local supermarket.

the fastest growing brand in the Hershey Pasta Group. Regional preferences were addressed with items such as SKINNER Lone Star Pasta, timed to coincide with the Texas Sesquicentennial.

New television commercials were aired for the AMERICAN BEAUTY and SKINNER brands in 1986, and the Group was the heaviest television advertiser in the pasta industry category during the year. The Group's acquisition in December 1986 of G&R Pasta Company, Inc., a small specialty pasta manufacturer in Philadelphia, reflects a continued commitment to provide a full range of pasta products that meet consumer needs.

Quality control of raw ingredients is particularly important in years during which the durum wheat crop is affected by adverse weather conditions. Although production in 1986 was high, current estimates of good milling grade durum wheat are lower than normal. Custom milling arrangements enable the Group to monitor and control raw ingredients to ensure that the final product is of the highest quality.

The geographic location of Hershey Pasta Group's manufacturing and distribution facilities and the ability to deliver consistent product specifications to customers across the nation, regardless of location, have resulted in the Group becoming a full-line supplier to not only the retail pasta industry, but to the food service, institutional and industrial markets as well.

Capital investments in the Lebanon facility in 1986 included installation of a new, short cut drying line, new flour unloading equipment, and automated packaging equipment for specialty items. New packaging equipment at the Louisville, Fresno, Omaha and Kansas City plants also made significant contributions to the overall productivity effort.

Capital investments, process and procedure changes, economies of scale in purchasing and, most importantly, employee motivation and dedication continue to form the cornerstone of the Hershey Pasta Group's productivity program, resulting in substantial cost reductions in 1986.

PETYBON INDUSTRIAS ALIMENTICIAS, S.A.

Petybon Industrias Alimenticias, S.A., Hershey's Brazilian subsidiary, performed well in a difficult and uncertain economic environment. Despite the closing of Petybon's plant in March during the implementation of the Brazilian government's new economic and currency plan, Petybon was able to regain lost sales volume by year-end.

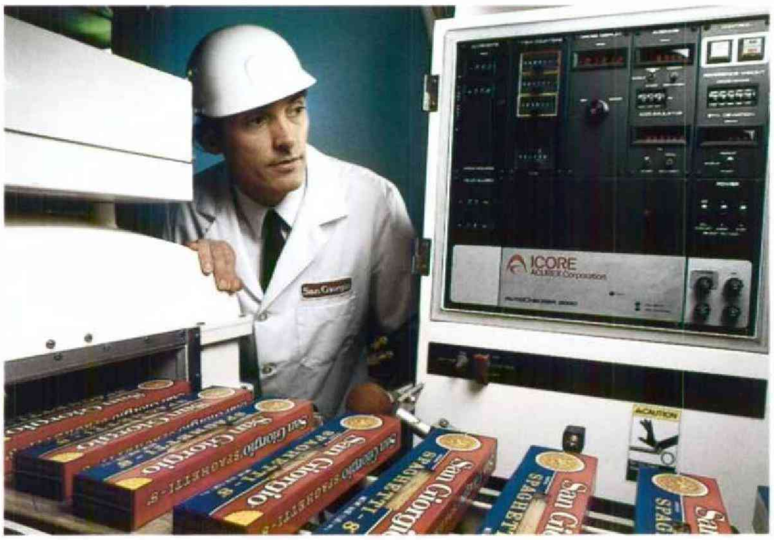
Margins improved relative to the low levels experienced in 1984 and 1985 as a consequence of Brazilian government price controls affecting raw material costs in those years. During the

Hershey Pasta Group's success is, in part, based upon the ability to develop recipes, nutritional information and cooking tips emphasizing pasta's economy, versatility and health benefits. Here, Dan Carlin, Director, Quality Assurance, meets with Mari-Lou Callahan, Hershey Kitchens Home Economist, to review newly-developed pasta recipes.

year, Petybon was able to improve market share on a regional and national basis in Brazil for both the pasta and biscuit categories. Interest expense declined substantially from 1985 levels.

An important development in Brazil was the merger of the Lacta/Hershey BROWN COW syrup operation into Petybon. This liquid milk modifier is now available for sale on a national basis and is gaining rapid acceptance among Brazilian consumers.

An agreement was concluded in December 1986 to establish a joint venture in Brazil with the Bunge Born Group and to combine one of its pasta operations with Petybon. This new business combination, of which Hershey International owns 45 percent, enhances Petybon's long-term growth prospects in an important consumer market. The Bunge Born Group is one of the largest flour and fat suppliers in Brazil and is a large distributor of consumer products.



Hershey Pasta Group emphasizes the development of package types which will not only attract consumers' attention in a crowded shopping aisle, but will meet their nutritional information needs and safeguard product quality. Pat Kilgore, Plant Manager, inspects packaging at the Group's SAN GIORGIO manufacturing plant in Lebanon, Pa.

The Hershey tradition is based on the highest standards of quality, fairness and integrity—a unique heritage which evolved from one man who, in his daily life, demonstrated a spirit of generosity and unselfishness rivaled by few others. Milton S. Hershey practiced these principles during his lifetime and set the example by which Hershey Foods Corporation has been guided.

Although enormously successful in business, Mr. Hershey's contributions to the community and society were considerably more significant. The Corporation perpetuates this legacy, making significant contributions to the communities in which it operates and to society in general.

Hershey makes cash and product contributions to a variety of worthy causes, including national organizations such as the United Way and The Children's Miracle Network Telethon, and to local charitable organizations in areas where its employees live and work. Hershey also contributes money each year to institutions of higher education under its employee gift matching program and through grants for specific projects.

Hershey's National Track & Field Youth Program is another example of its commitment to improving the quality of community life. This playground program introduces children between the ages of 9 and 14 to physical fitness through basic track and field events, encouraging them to be the best they possibly can be. Nearly 500 young people from communities around the country participate in the Program's National Final, held each year in Hershey, Pa.

Friendly Ice Cream Corporation continues the philosophy of social responsibility started over 50 years ago by co-founders Curtis and S. Prestley Blake. The Friendly Readers Program, established in 1983, is designed to introduce elementary school students to recreational reading by offering incentives such as ice cream cones and the donation of school library books in a child's name. Friendly has donated a total of 17,321 books to 64 school libraries since 1983. Nearly 300,000 books have been read as part of the program.

Other activities include Hershey's free film lending program, developed over 50 years ago to inform students, teachers, service organizations and other community groups about the chocolate manufacturing process; its sponsorship of quality public television programming for young people; and its active encouragement of employee involvement in a wide variety of charitable and community activities.

Hershey Foods remains committed to its founder's belief that businesses, like individuals, have a moral and ethical responsibility to society. Although Mr. Hershey's company has changed tremendously over the years, his beliefs have not been compromised. On the contrary, they have been reinforced.

Hershey's National Track & Field Youth Program exemplifies the Corporation's dedication to the future well-being of America's youth. The program provides nearly 250,000 young boys and girls each year with a wholesome, recreational activity that emphasizes friendship, sportsmanship and physical exercise.

HERSHEY STOCKHOLDERS

As of December 31, 1986, the Corporation had outstanding 74,886,450 shares of Common Stock and 15,299,886 shares of Class B Common Stock owned by 23,502 stockholders of record. Share amounts reflect the three-for-one stock split effective September 15, 1986, and the Corporation's November 14, 1986, purchase of 3,825,000 Common Stock shares from Hershey Trust Company as Trustee for Milton Hershey School, its largest stockholder.

STOCK MARKET DATA

Hershey's Common Stock is listed and traded principally on the New York Stock Exchange under the ticker symbol "HSY." Class B Common Stock is not listed for trading. The stock tables of most financial publications list the Corporation as "Hrshy." Options on Hershey's Common Stock are traded on the American Stock Exchange.

Common Stock—Approximate Share Volume

Year	Annual Composite Trading	Average Daily
1986	22,838,000	90,000
1985	8,566,000	34,000
1984	7,852,000	31,000

1986	Common Stock Price High	Low	Close	Dividend Common	Class B
(calendar quarter)					
1st Qtr.	\$21⅜	\$15½	\$21¼	\$.1250	\$.1133
2nd Qtr.	26⅞	19⅛	26⅞	.1250	.1133
3rd Qtr.	30	21⅜	21⅝	.1350	.1225
4th Qtr.	26½	21	24⅝	.1350	.1225

ANNUAL MEETING

The Annual Meeting of Stockholders will be held at 2:00 p.m. on Monday, April 27, 1987, at the Hershey Theatre, East Caracas Avenue (near Cocoa Avenue) in Hershey, Pa.

A formal notice of this meeting, together with a proxy statement, is being mailed to stockholders on or about March 6, 1987.

Voting results and highlights of the meeting will be mailed to stockholders in May 1987 as part of the First Quarter Report to Stockholders.

DIVIDEND POLICY

Dividends on both the Corporation's Common Stock and Class B Common Stock are declared by the Board of Directors, and are normally paid in the months of March, June, September and December. The dividend on the Common Stock to be paid in March 1987 will be the 229th consecutive regular dividend paid by the Corporation.

AUTOMATIC DIVIDEND REINVESTMENT SERVICE

Stockholders may build their investment in Hershey by enrolling in the Corporation's Automatic Dividend Reinvestment Service.

Brokerage commissions and agent fees associated with the service are paid by Hershey. For information write to the Corporation's Office of the Secretary in Hershey, or the Dividend Reinvestment Department of Manufacturers Hanover Trust Company, P.O. Box 24850, Church Street Station, New York, N.Y. 10249.

PUBLICATIONS FOR STOCKHOLDERS

In addition to the Annual Report, Hershey informs stockholders about news through:

- Quarterly Reports—mailed in February, May, August and November.
- Notice of Annual Meeting of Stockholders and Proxy Statement—mailed to stockholders in early March.
- Form 10-K—filed annually in March with the Securities and Exchange Commission. Stockholders may obtain a free copy of this report from the Office of the Secretary, Corporate Administrative Center, Hershey Foods Corporation, P.O. Box 814, Hershey, Pa. 17033-0814.

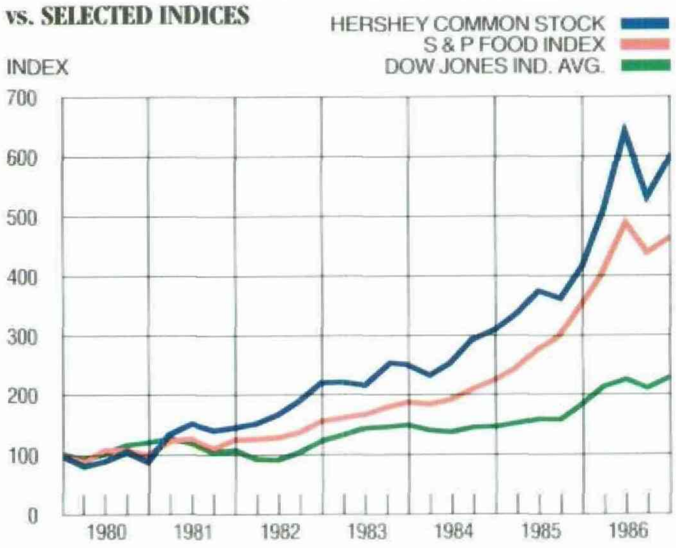
The Corporation maintains a mailing list for those street-name stockholders who wish to receive published information on a timely basis. Stockholders on the list will have reports mailed directly to them, rather than through a third party. For more information, contact the Corporation's Investor Relations Department.

FOR MORE INFORMATION

For information about your stockholder account, please contact the Corporation's transfer agent, Manufacturers Hanover Trust Company, P.O. Box 24935, Church Street Station, New York, N.Y. 10249. Be sure to mention Hershey Foods Corporation and include an account number in any correspondence.

Hershey maintains an active investor relations program to keep stockholders well informed and to attract new investors. Comments or requests for information should be directed to the Investor Relations Department, Corporate Administrative Center, Hershey Foods Corporation, P.O. Box 814, Hershey, Pa. 17033-0814.

HERSHEY FOODS COMMON STOCK PERFORMANCE vs. SELECTED INDICES



FINANCIAL REVIEW

CONTENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Corporation operates in three industry segments: Chocolate and Confectionery, Restaurant Operations and Other Food Products. Operations in the Chocolate and Confectionery segment involve manufacture and sale of a broad line of chocolate and confectionery products. The principal product groups sold are bar goods, bagged items, baking ingredients, chocolate drink mixes, dessert toppings and cough drops. The Restaurant Operations segment is engaged in the operation of restaurants (over 825 at December 31, 1986) and the manufacture of certain products sold in those restaurants. The Other Food Products segment includes the manufacture and sale of pasta products in the U.S. and Brazil, and biscuit and margarine products in Brazil.

The schedule on page 22 presents net sales, operating income, identifiable assets and other information for the three industry segments. Additional financial information is contained in the Six-Year Consolidated Financial Summary on page 40.

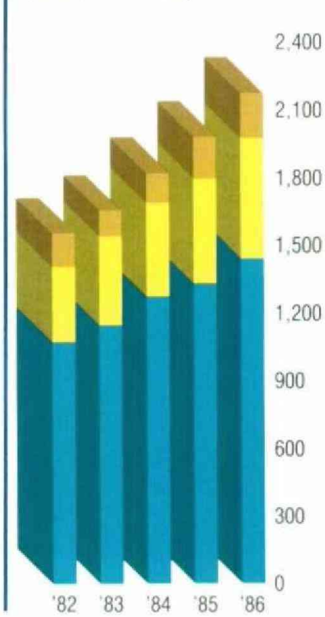
All shares and per share information have been restated for the three-for-one stock split effective September 15, 1986. The weighted average number of outstanding shares of Common Stock and Class B Common Stock was 93,508,322 in 1986 and 94,011,336 in 1985 and 1984. The computation of weighted average shares outstanding in 1986 reflects the Corporation's purchase and retirement of 3,825,000 shares of Common Stock on November 14, 1986. The impact of reduced weighted average shares outstanding on net income per share was immaterial.

In November 1985, the Corporation sold the stock of Cory Food Services, Inc. and Cory Canada Inc. (Cory). Accordingly, the Consolidated Statements of Income for 1985 and 1984 reflect Cory as discontinued operations.

The following discussion relates to continuing operations. Information on discontinued operations is contained in Note 3 to the Consolidated Financial Statements.

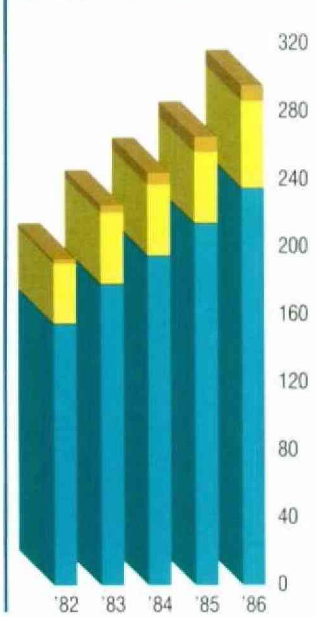
NET SALES BY INDUSTRY SEGMENT

(dollars in millions)



OPERATING INCOME BY INDUSTRY SEGMENT

(dollars in millions)



CHOCOLATE AND CONFECTIONERY
RESTAURANT OPERATIONS
OTHER FOOD PRODUCTS

RESULTS OF OPERATIONS

Consolidated

The Corporation achieved sales and earnings growth in 1986 and 1985. Consolidated net sales have increased during this two-year period by an annual compounded growth rate of 8%, with unit volumes and selling prices contributing to the increase. Income from continuing operations has increased by an annual compounded growth rate of 10% during the two-year period. An increase in gross profit margins was partly offset by higher effective income tax rates. The effective income tax rate increased to 49.1% in 1986 from 48.0% in 1984, principally due to the impact of the Tax Reform Act of 1986.

Gross profit margins increased in both years, as selected selling price increases, together with manufacturing efficiencies, have more than offset the impact of slightly higher costs of certain commodities and of increased weights of standard chocolate and confectionery items in 1986. Increased gross profit margins in both years were partially offset by higher levels of selling and marketing expenditures.

Net interest expense decreased in 1986 compared with 1985. Reduced interest expense from lower foreign short-term borrowings in 1986 more than offset increased domestic net interest expense incurred to support working capital requirements, acquisitions and the purchase of the Corporation's Common Stock. Net interest expense increased in 1985 compared with 1984, primarily related to higher foreign borrowing levels.

Net Sales

Consolidated net sales in 1986 of $2,169.6 million rose $173.5 million or 9% over 1985, with the majority of the increase resulting from higher sales volumes. The Chocolate and Confectionery segment net sales increase related to both higher selling prices and unit volume, while volume growth accounted for most of the net sales increase for the Restaurant Operations segment. The net sales increase for the Other Food Products segment was attributable to unit volume growth in domestic pasta.

Consolidated net sales in 1985 of $1,996.2 million grew by $147.7 million or 8% over 1984, with most of the increase resulting from higher sales volumes. Chocolate and Confectionery and Other Food Products segments

increases reflected principally unit volume growth, while the majority of the net sales increase in the Restaurant Operations segment related to higher selling prices.

Unit volume increases in both years related to acquired businesses, new product introductions, new restaurants and expanded product distribution, in addition to increased sales volumes of existing products.

Income from Continuing Operations

Income from continuing operations rose 10% to $132.8 million in 1986 and income per share from continuing operations increased 11% to $1.42 compared with $1.28 in 1985. Gross profit margins were 33.0% in 1986 and 32.1% in 1985, as selling price increases, stable-to-lower costs of raw materials in 1986, notably cocoa beans, sugar, milk and flour, and the adoption of FAS No. 87 (as discussed below) more than offset the effects of increased weights of standard chocolate and confectionery items and higher costs of peanuts, almonds and restaurant labor. Selling, general and administrative expenses increased 13%, reflecting increased expenditures to support existing products in highly competitive markets and new product introductions. Net interest expense decreased to $9.8 million in 1986 from $11.9 million in 1985 reflecting lower foreign borrowing costs more than offsetting increased domestic net interest expense associated with financing the acquisition of The Dietrich Corporation and purchase of Common Stock during the fourth quarter of 1986.

During 1986, the Corporation adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (FAS No. 87), which reduced pension expense for the year by approximately $7.3 million. The effect of this change in accounting for pensions was offset by an increase in the effective income tax rate from 48.2% in 1985 to 49.1% in 1986. The higher effective income tax rate is primarily due to the Tax Reform Act of 1986 which retroactively eliminated investment tax credits of approximately $3.6 million for capital investments initiated and placed in service subsequent to December 31, 1985.

Income from continuing operations increased 9% to $120.6 million in 1985 compared with 1984. Income per share from continuing operations was $1.28 compared with $1.17 in 1984. Gross profit margins increased from 31.3% in 1984 to 32.1% in 1985, reflecting selected selling price increases and stable costs of most raw materials. The 11% increase in selling, general and administrative expenses primarily reflected higher selling and marketing expenses. Net interest expense increased from $10.3 million in 1984 to $11.9 million in 1985 due to higher foreign borrowing costs. The effective income tax rate increased from 48.0% in 1984 to 48.2% in 1985.

Chocolate and Confectionery

In 1986, the Chocolate and Confectionery segment's net sales grew $104.1 million or 8%. This followed an increase of $49.8 million or 4% in 1985 compared with 1984. The 1986 increase was attributable to both increased selling prices and unit volume, including sales of The Dietrich Corporation subsequent to the October 27, 1986 date of acquisition. Increased selling prices accounted for the majority of the 1986 increase, whereas increased unit volume contributed the majority of the 1985 increase. In January 1986, the selling price of the Hershey Chocolate Company's standard bar line was increased an average of 14%. As a result, the consumer price increased from $.35 to $.40 in most retail outlets. In July 1986, Hershey Chocolate Company increased the weight on a major portion of its standard bar line. Most of the weight increases were in a range of 10% to 14%.

Operating income in 1986 increased $22.1 million or 10% compared with 1985. The operating margin (income from operations as a percentage of net sales) was higher in 1986 than in 1985, as stable-to-lower costs for most raw materials, manufacturing and distribution efficiencies, increases in selling prices and the adoption of FAS No. 87 more than offset the higher cost of peanuts and almonds, increased standard bar line weights and higher selling and marketing expenses. Selling and marketing expenses increased primarily as a result of higher levels of trade promotions and advertising.

In 1985, operating income increased $16.9 million or 9% compared with 1984. The operating margin was higher in 1985 than in 1984, as stable-to-lower costs for most raw materials, manufacturing and distribution efficiencies, and increases in selling prices more than offset the higher cost of cocoa beans and slightly higher selling and marketing expenses. Selling and marketing expenses increased primarily due to higher levels of trade promotions and advertising.

Restaurant Operations

Net sales for the Restaurant Operations segment grew by $65.0 million or 14% in 1986 compared with 1985. This followed an increase of $44.4 million or 10% in 1985 compared with 1984. Sales growth in 1986 was attributable to volume gains and selling price increases. New restaurant openings, small restaurant chain acquisitions since the third quarter of 1985 and expanded menu offerings contributed to volume growth in 1986. Increased sales in 1985 were due to selling price increases and volume gains relating to new restaurant openings and sales of new products.

In 1986, operating income increased $7.1 million or 16% compared with 1985. Operating margins increased in 1986 primarily as a result of the adoption of FAS No. 87, since increased sales volume, higher selling prices and stable food costs were more than offset by higher restaurant labor costs and marketing expenses. In 1986, Friendly opened 49 restaurants at new locations and added 35 restaurants as the result of the two restaurant chain acquisitions during the year. In 1985, Friendly opened 40 restaurants and added 12 restaurants as a

INDUSTRY SEGMENT DATA

(in thousands of dollars)

For the years ended December 31,	1986	1985	1984
Net sales:[1]			
Chocolate and Confectionery	$1,441,054	$1,336,909	$1,287,100
Restaurant Operations	536,461	471,488	427,122
Other Food Products[2]	192,099	187,757	134,270
Total net sales	$2,169,614	$1,996,154	$1,848,492
Income from continuing operations before interest and income taxes:			
Chocolate and Confectionery	$ 234,776	$ 212,717	$ 195,810
Restaurant Operations	50,435	43,309	41,770
Other Food Products[2]	9,869	11,024	7,726
General corporate expenses	(24,448)	(22,208)	(22,464)
Income from continuing operations before interest and income taxes	270,632	244,842	222,842
Interest expense, net	(9,799)	(11,929)	(10,349)
Income from continuing operations before income taxes	260,833	232,913	212,493
Less: Provision for income taxes	128,069	112,264	102,058
Income from continuing operations	$ 132,764	$ 120,649	$ 110,435
Identifiable Assets at December 31:[3]			
Chocolate and Confectionery	$ 820,950	$ 611,425	$ 580,586
Restaurant Operations	358,779	310,955	273,356
Other Food Products	110,418	120,763	152,747
Corporate	66,156	154,289	115,878
Total assets	$1,356,303	$1,197,432	$1,122,567
Depreciation:			
Chocolate and Confectionery	$ 22,484	$ 20,171	$ 17,636
Restaurant Operations	25,109	21,616	18,874
Other Food Products[2]	6,958	6,761	3,733
Corporate	1,436	1,096	1,079
Total depreciation	$ 55,987	$ 49,644	$ 41,322
Capital additions:			
Chocolate and Confectionery	$ 62,423	$ 51,895	$ 37,508
Restaurant Operations	61,496	53,330	41,885
Other Food Products[2]	7,966	6,947	4,311
Corporate[4]	3,943	2,277	3,345
Total capital additions	$ 135,828	$ 114,449	$ 87,049

(1)No customer, government or other entity accounts for 10% or more of sales. Intersegment sales are not separately stated because such sales are not significant. Foreign sales and assets account for less than 10% of total sales and assets.

(2)Net sales, income from continuing operations, depreciation and capital additions for the Other Food Products segment for 1984 have been restated to reflect the sale of Cory Food Services, Inc. and Cory Canada Inc. (Cory) in November 1985.

(3)Identifiable assets are those assets that are used in the Corporation's operations in each segment. Corporate assets are principally cash and short-term investments, and corporate property and equipment.

(4)Corporate capital additions include capital additions of Cory through the date of disposition.

result of the acquisition of a restaurant chain in September 1985.

During 1985, operating income increased $1.5 million or 4% compared with 1984. Operating margins declined in 1985, primarily reflecting higher restaurant labor costs.

Other Food Products

Net sales for the Other Food Products segment increased $4.3 million or 2% in 1986 compared with 1985. Higher net sales were achieved by the domestic pasta operations, while Petybon, the Corporation's for-

merly wholly-owned subsidiary in Brazil, reported lower sales in 1986 compared with 1985. The majority of the sales increase for domestic pasta was related to unit volume growth. Increased unit sales volume for Petybon was more than offset by the devaluation of the Brazilian currency relative to the U.S. dollar.

Net sales for the Other Food Products segment in 1985 increased $53.5 million or 40% compared with 1984. The sales increase primarily related to pasta unit volume growth associated with American Beauty, the assets and business of which were acquired in November 1984.

Operating income in 1986 decreased $1.2 million or 10% compared with 1985. The domestic pasta operating margin was higher than prior year due to lower commodity costs which more than offset higher selling and marketing expenditures as a percentage of sales. This favorable performance was more than offset by reduced translation gains as a result of the reduction in foreign borrowings and stabilization of the Brazilian currency. The reduction in foreign borrowings, however, resulted in a favorable impact on net interest expense.

On December 15, 1986, the Corporation entered into a joint venture agreement under which Petybon was combined with another Brazilian pasta manufacturing company. The Corporation retained a 45% equity interest in the combined joint venture. Accordingly, the Corporation adopted the equity method of accounting effective December 1986.

In 1985, operating income rose $3.3 million or 43% compared with 1984. The increase primarily reflected the inclusion of American Beauty in 1985. The domestic pasta operating margin was approximately equal to prior year, as lower commodity costs and selected selling price increases were offset by higher selling and marketing expenditures as a percentage of net sales.

General Corporate Expenses

General corporate expense amounts were higher in 1986 compared with 1985, reflecting gains in 1985 on the repurchase of debentures with no comparable income in 1986. General corporate expense amounts were comparable in 1985 and 1984.

FINANCIAL CONDITION

Liquidity

During 1986, the Corporation's cash and short-term investments decreased by $83.0 million. Funds used to finance capital additions ($135.8 million), business acquisitions ($115.5 million, net of working capital acquired), the purchase of 3,825,000 shares of the Corporation's Common Stock ($86.9 million) and dividends ($48.1 million) exceeded cash provided from continuing operations and the issuance of long-term debt. After a net $36.5 million increase in working capital requirements, primarily to fulfill raw material procurement strategies, cash provided from continuing operations was $187.0 million.

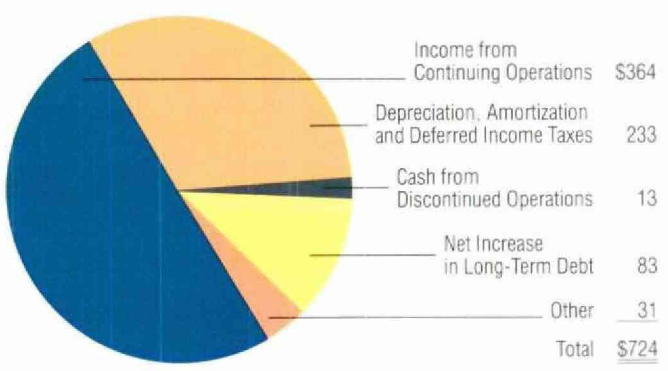
The net increase in long-term debt of $100.6 million was used principally to repay interim short-term debt incurred to finance the acquisition of the outstanding shares of capital stock of The Dietrich Corporation and the purchase of the Corporation's Common Stock from its majority stockholder, Hershey Trust Company, as Trustee for Milton Hershey School.

During 1985 and 1984, income from continuing operations was the Corporation's principal source of funds. Internally generated funds were more than sufficient to finance the Corporation's investment activities during those years.

Investment activities over the past three years, essential for the Corporation's continued growth, included capital expenditures for new manufacturing equipment, expansion of existing facilities and construction of new distribution and restaurant facilities. The Corporation also used funds for acquisitions in all business segments, primarily The Dietrich Corporation in 1986 and American Beauty in 1984.

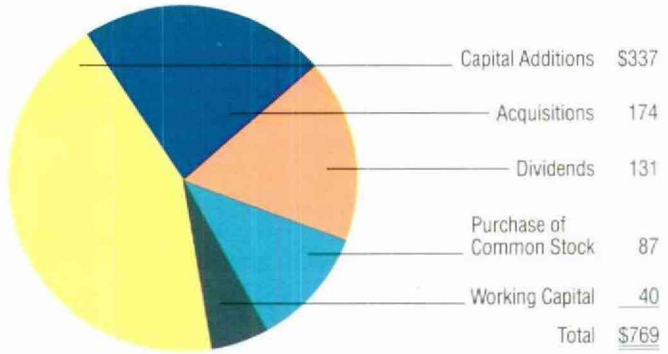
THREE-YEAR PRINCIPAL SOURCES OF FUNDS

(dollars in millions)



THREE-YEAR PRINCIPAL USES OF FUNDS

(dollars in millions)



The Corporation's sales, income from continuing operations and related working capital requirements are affected by seasonal sales patterns. Chocolate and Confectionery segment seasonal and holiday related sales are typically highest during the third and fourth quarters of the year, representing the principal seasonal effect on the Corporation. Restaurant Operations segment sales are highest in the second and third quarter warm weather seasons, while domestic pasta sales are somewhat higher during the cooler weather periods.

Generally, the Corporation's domestic seasonal working capital needs have exceeded funds generated from normal operations, and interim financing has been required. These needs have been met by issuing commercial paper and/or through short-term commercial bank borrowings. Typically, the Corporation's seasonal needs for working capital peak during the summer months and domestic short-term borrowings generally have been repaid in the fall. In 1986, only minimal domestic short-term borrowings were required to fund seasonal working capital requirements; however, interim short-term debt was incurred during the fourth quarter of 1986 to partially finance the acquisition of The Dietrich Corporation and the purchase of the Corporation's Common Stock. This short-term debt was repaid in November 1986 with proceeds from the issuance of long-term debt. No seasonal borrowings were required in 1985.

At December 31, 1986, the Corporation had $8.4 million of current portion of long-term debt and $27.6 million of cash and short-term investments. Bank lines of credit which may be borrowed directly or used to support the issuance of commercial paper were $100 million. In 1985 and 1984, the Corporation repurchased $14.4 million and $4.5 million, respectively, of its sinking fund debentures and other obligations to meet future sinking fund requirements.

At December 31, 1986, the Corporation's principal capital commitments included the installation of manufacturing equipment and the construction of FRIENDLY restaurants.

On November 14, 1986, the Corporation's largest stockholder, Hershey Trust Company, as Trustee for Milton Hershey School (Hershey Trust), sold 5,175,000 shares of Hershey Foods Corporation Common Stock, $1.00 par value, in an underwritten secondary public offering. On the same date, the Corporation purchased 3,825,000 shares of its Common Stock from Hershey Trust at $22.72 per share, a price equal to the proceeds per share to Hershey Trust in the secondary public offering. The acquired shares were retired and became authorized and unissued shares of Common Stock.

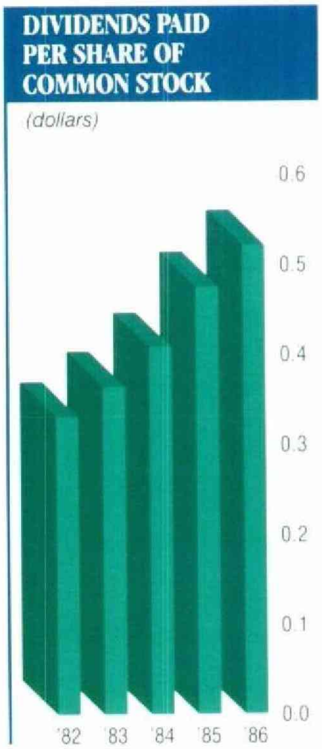
Hershey Trust sold the shares in order to diversify its investment portfolio. Additionally, Hershey Trust has indicated that, subject to its fiduciary obligations, it has no intention of selling any additional shares of the Common Stock and intends to maintain voting control of the Corporation.

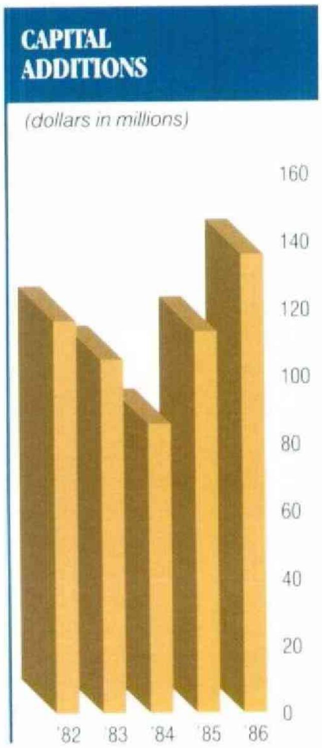
The ratio of current assets to current liabilities was 1.8:1 at December 31, 1986, 2.1:1 in 1985 and 1.9:1 in 1984. The Corporation's debt as a percentage of total capitalization (stockholders' equity and total short-term and long-term debt) was 23% at December 31, 1986, 14% in 1985 and 17% in 1984. The increase in 1986 over 1985 resulted from the November 25, 1986 issuance of $50.0 million 7% Notes due November 15, 1989 and $50.0 million 9⅛% Sinking Fund Debentures due December 15, 2016, together with the purchase and retirement of the Corporation's Common Stock. The decrease in 1985 resulted from increased stockholders' equity and reductions in long-term debt.

Tax Reform Act of 1986

The Tax Reform Act of 1986 (Act) has impacted the Corporation's results of operations for the year ended December 31, 1986, principally through the provisions which repeal the investment tax credit for capital investments initiated and placed in service subsequent to December 31, 1985. The resulting reduction in allowable investment tax credits for 1986 increased the effective income tax rate for the year to 49.1% compared with 48.2% for 1985.

For future years, the Act reduces the statutory Federal corporate income tax rate from 46% in 1986 to 40% in 1987 and to 34% in 1988. The lower statutory income tax rate is expected to more than offset the elimination of investment tax credits, resulting in a lower effective





income tax rate being achieved with no significant changes anticipated in capital investment programs. The reduction in future effective income tax rates will not necessarily have a corresponding effect on net income for a variety of reasons, including expenditures on programs designed to increase sales and enhance market share.

The reductions in effective income tax rates affect not only taxes which will be payable currently in future years, but also the amount of deferred income taxes provided through December 31, 1986, which will be payable in future years. Under existing Generally Accepted Accounting Principles, the provision for deferred income taxes is based on income tax rates in effect when timing differences arise for financial reporting purposes. Subsequent changes in tax rates do not result in adjustment of deferred income tax liabilities until the timing differences are recognized for income tax purposes. Accordingly, the Federal deferred income tax liability as of December 31, 1986, has been provided based upon statutory Federal income tax rates approximating 46%. However, the Financial Accounting Standards Board recently released an exposure draft of a new accounting standard that would, if adopted, change the accounting for income taxes. Among other changes, this new accounting standard provides for recording deferred income taxes at tax rates in effect when the timing differences are expected to reverse. If applied as of December 31, 1986, this proposed change in accounting, together with the reduction in income tax rates under the Act, would have significantly reduced the reported deferred income tax liability with a corresponding increase in net income.

Effects of Inflation

The Corporation monitors the effects of inflation and various steps, including selling price and weight changes, are taken to minimize its impact on the Corporation's business. The use of LIFO inventory accounting for most inventories matches current costs with current revenues and, in periods of inflation, reduces income taxes and improves cash flow. The capital expenditures program, through investment in modern plant and equipment, provides for future sales growth and manufacturing efficiencies. This approach to management of inflation, the generally stable costs of major commodities and other manufacturing materials, and the modest rate of inflation on other costs as measured by the Average Consumer Price Index, are the principal factors which have resulted in inflation having a minimal effect on reported results of operations and financial condition for 1986, 1985 and 1984.

MARKET PRICES AND DIVIDENDS

Cash dividends paid on the Corporation's Common Stock and Class B Common Stock (Class B Stock) were $48.1 million in 1986 and $43.9 million in 1985. After adjustment for the three-for-one stock split, the annual dividend rate on the Common Stock is $.54 per share, an increase of 8% over the 1985 rate of $.50 per share. The 1986 dividend represents the 12th consecutive year of Common Stock dividend increases.

On February 11, 1987, the Corporation declared a regular quarterly dividend of $.135 per share of the Common Stock payable on March 13, 1987, to stockholders of record February 27, 1987. It is the Corporation's 229th consecutive regular Common Stock dividend. A regular quarterly dividend of $.1225 per share of the Class B Stock was also declared. Cash dividends paid on shares of the Common Stock are required to be 10% higher than those paid on the Class B Stock.

Hershey Foods Corporation Common Stock is listed and traded principally on the New York Stock Exchange under the symbol HSY. Approximately 22.8 million shares of the Corporation's Common Stock were traded during 1986. The closing price of the Common Stock on the New York Stock Exchange on December 31, 1986, was $24⅝. The Class B Stock is not publicly traded. There were 23,502 stockholders of record of the Common Stock and the Class B Stock at December 31, 1986.

The New York Stock Exchange (NYSE) presently has a rule against listing the common stock of companies which have more than one class of common stock with unequal voting power. In September 1986, the NYSE's Board of Directors voted to change this rule to allow NYSE listed companies to have different classes of common stock with unequal voting power, provided that the voting provisions of the classes of common stock have been approved by (i) a majority of independent directors and (ii) a majority of votes eligible to be cast by public shareholders. "Public shareholders" are those who are not directors, officers, members of their immediate families or their affiliates, or affiliates of the issuer. Hershey Foods Corporation believes its dual class capitalization adopted in 1984 meets these approval requirements.

As required by Federal securities laws, the NYSE filed its proposed rule change with the Securities and Exchange Commission (SEC) for its approval, and the SEC published notice of the proposed rule change on October 22, 1986. On December 16 and 17, 1986, the SEC held public hearings on the proposed rule change. The SEC has not announced when it will make a decision to approve or disapprove the rule change. If the SEC approves the NYSE rule change, or disapproves the rule change but provides for a "grandfathering" of companies having dual class capitalizations, the Corporation's Common Stock would continue to be traded on the NYSE. If the SEC disapproves the rule change and does not "grandfather" current dual class companies, the Corporation's Common Stock would no longer be eligible for trading on the NYSE. In that event, the Corporation would take steps to have its Common Stock traded in an appropriate market system that would ensure adequate liquidity for investors wishing to purchase or sell shares of Common Stock.

The following table shows the dividends paid per share of Common Stock and Class B Stock and the price range of the Common Stock for each quarter of the past two

years. The amounts have been adjusted for the three-for-one stock split effective September 15, 1986.

	Dividends Paid Per Share		Common Stock Price Range*	
	Common Stock	Class B Stock	High	Low
1986				
1st Quarter	$.1250	$.1133	$21⅜	$15½
2nd Quarter	.1250	.1133	26⅞	19⅛
3rd Quarter	.1350	.1225	30	21⅜
4th Quarter	.1350	.1225	26½	21
	$.5200	$.4716		
1985				
1st Quarter	$.1167	$.1050	$14	$11⅝
2nd Quarter	.1167	.1050	16½	13⅛
3rd Quarter	.1167	.1050	16⅜	14¼
4th Quarter	.1250	.1133	18⅜	14⅞
	$.4751	$.4283		

*NYSE-Composite Quotations for Common Stock by calendar quarter.

CAPITAL ADDITIONS

The Corporation regularly invests in capital additions, providing for growth, productivity and capacity sustaining programs. Capital additions, including capitalized interest and property subject to capitalized leases, in 1986 were $135.8 million compared with $114.4 million in 1985 and $87.0 million in 1984.

Chocolate and Confectionery segment additions accounted for $62.4 million (excluding the acquisition of $22.7 million of The Dietrich Corporation property, plant and equipment) or 46% of total spending for 1986 compared with $51.9 million or 45% in 1985. In 1986 and 1985, additions consisted principally of installations of production equipment for new and existing products, expansion of manufacturing facilities and construction of a new distribution center.

The Restaurant Operations segment accounted for $61.5 million or 45% of the total spending for 1986 compared with $53.3 million or 47% in 1985. Approximately 72% of the spending was for restaurants opened at 49 new locations during 1986 and new restaurant locations scheduled to open subsequent to 1986. Other additions included the renovation of existing restaurants and other improvements. In 1985, 40 restaurants at new locations were opened.

The Other Food Products segment accounted for $8.0 million or 6% of the 1986 total spending compared with $6.9 million or 6% in 1985. Additions during 1986 and 1985 primarily related to pasta manufacturing equipment and facilities.

Corporate additions were $3.9 million or 3% of total spending in 1986 compared with $2.3 million or 2% in 1985. Additions during the periods included expansion of research and development facilities and equipment, renovation of Corporate facilities and the addition of a Corporate aircraft.

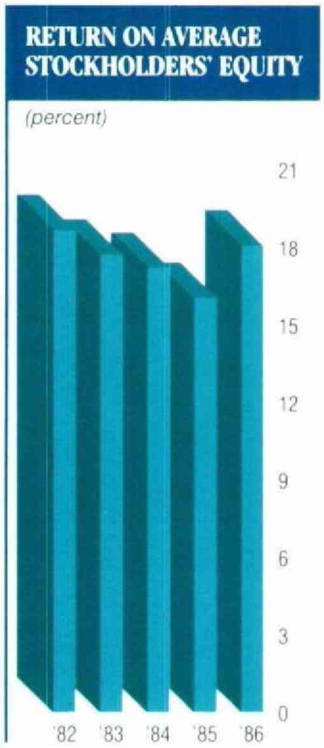
Depreciation expense and amortization of leasehold improvements and capitalized leases for 1986, 1985 and 1984 amounted to $56.0 million, $49.6 million and $41.3 million, respectively.

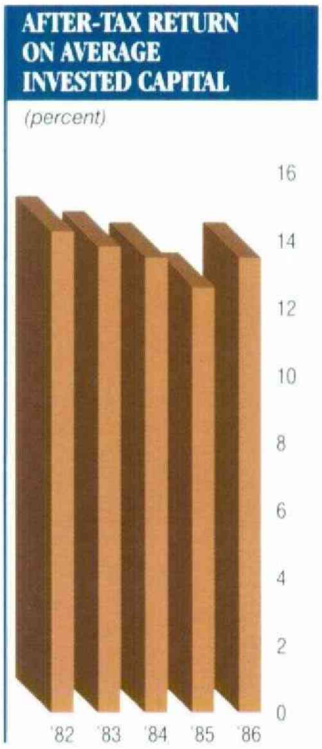
RETURN ON STOCKHOLDERS' EQUITY

The Corporation has increased consolidated net sales, net income and assets in each of the most recent five years. Its return on average stockholders' equity has ranged from 16.2% in 1985 (17.4% from continuing operations) to 18.8% in 1982; it was 18.2% in 1986.

RETURN ON INVESTED CAPITAL

The Corporation's after-tax return on average invested capital over the most recent five-year period has ranged from 12.7% in 1985 (13.6% from continuing operations) to 14.3% in 1982; it was 13.5% in 1986. Average invested capital consists of the average of beginning and end-of-year balances in long-term debt, deferred income taxes and stockholders' equity. Earnings on invested capital is the sum of net income and the after-tax effect of interest on long-term debt.





HERSHEY FOODS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands of dollars except per share amounts)

For the years ended December 31,	1986	1985	1984
Net Sales	**$2,169,614**	$1,996,154	$1,848,492
Costs and Expenses:			
Cost of sales	**1,453,440**	1,355,789	1,269,801
Selling, general and administrative	**445,542**	395,523	355,849
Total costs and expenses	**1,898,982**	1,751,312	1,625,650
Income from Continuing Operations before Interest and Income Taxes	**270,632**	244,842	222,842
Interest expense, net (Note 1)	**9,799**	11,929	10,349
Income from Continuing Operations before Income Taxes	**260,833**	232,913	212,493
Provision for income taxes (Note 7)	**128,069**	112,264	102,058
Income from Continuing Operations	**132,764**	120,649	110,435
(Loss) from Discontinued Operations (Note 3)	**—**	(8,422)	(1,753)
Net Income	**$ 132,764**	$ 112,227	$ 108,682
Income (Loss) per Share (Note 2)			
Continuing Operations	**$ 1.42**	$ 1.28	$ 1.17
Discontinued Operations (Note 3)	**—**	(.09)	(.01)
Net Income	**$ 1.42**	$ 1.19	$ 1.16

Cash Dividends Paid per Share of Common Stock (Note 2)	**$ .5200**	$ .4751	$ .4133
Cash Dividends Paid per Share of Class B Common Stock (Note 2)	**.4716**	.4283	.1050
Income from Continuing Operations before Interest and Income Taxes as a Percentage of Net Sales	**12.5%**	12.3%	12.1%
Income from Continuing Operations as a Percentage of Net Sales	**6.1%**	6.0%	6.0%

The notes to consolidated financial statements are an integral part of these statements.

HERSHEY FOODS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands of dollars)

December 31,	1986	1985
ASSETS		
Current Assets:		
Cash and short-term investments (Note 1)	$ 27,606	$ 110,636
Accounts receivable—trade (less allowances for doubtful accounts of $4,491 and $4,151)	77,382	76,617
Inventories (Note 1)	237,509	192,678
Prepaid expenses and other (Note 8)	50,923	32,359
Total current assets	393,420	412,290
Property, Plant and Equipment, at cost: (Note 1)		
Land	64,576	62,906
Buildings	251,075	221,901
Machinery and equipment	780,967	680,121
Capitalized leases	34,498	33,274
	1,131,116	998,202
Less—accumulated depreciation and amortization	337,792	296,435
	793,324	701,767
Intangibles Resulting from Business Acquisitions (Note 1)	149,025	66,240
Investments and Other Assets (Note 1)	20,534	17,135
	$1,356,303	$1,197,432

December 31,	1986	1985
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable (Note 4)	$ 102,959	$ 87,799
Accrued liabilities		
Payroll and other compensation costs	40,474	37,275
Advertising and promotional expenses	18,906	19,828
Other	34,414	31,544
	93,794	88,647
Accrued income taxes	16,990	9,253
Short-term debt and current portion of long-term debt (Notes 4 and 5)	8,400	9,623
Total current liabilities	222,143	195,322
Long-Term Debt (Notes 5 and 6)	210,792	110,169
Other Long-Term Liabilities	36,497	31,216
Deferred Income Taxes (Note 7)	158,930	132,826
Stockholders' Equity: (Note 2)		
Common Stock, $1 par value, outstanding shares: 74,886,450 in 1986; 26,235,710 on a pre-split basis in 1985	74,886	26,236
Class B Common Stock, $1 par value, outstanding shares: 15,299,886 in 1986; 5,101,402 on a pre-split basis in 1985	15,300	5,101
Additional paid-in capital	51,681	54,006
Cumulative foreign currency translation adjustments	(6,123)	(8,579)
Retained earnings	592,197	651,135
Total stockholders' equity	727,941	727,899
	$1,356,303	$1,197,432

The notes to consolidated financial statements are an integral part of these balance sheets.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

(in thousands of dollars)

For the years ended December 31,	1986	1985	1984
Cash Provided from (Used by) Continuing Operations			
Income from continuing operations	$ 132,764	$ 120,649	$ 110,435
Depreciation and amortization	58,975	52,351	42,770
Deferred income taxes	26,488	30,268	22,454
Working capital provided from continuing operations	218,227	203,268	175,659
Changes in working capital (excluding cash and short-term investments and debt):			
Inventories	(44,831)	(6,725)	8,713
Accounts receivable	(765)	4,360	(24,521)
Accounts payable	15,160	(8,579)	29,271
Other	(6,064)	(9,602)	3,167
Other long-term liabilities	5,281	6,136	2,713
Cash provided from continuing operations	187,008	188,858	195,002
Cash Provided from Discontinued Operations	—	12,062	638
Cash Dividends Paid	(48,146)	(43,942)	(38,680)
Cash Provided from (Used for) Investment Transactions			
Capital additions	(135,828)	(114,449)	(87,049)
Business acquisitions, net of working capital acquired	(115,498)	(6,479)	(52,199)
Other	16,938	(1,117)	(931)
Cash (used for) investment transactions	(234,388)	(122,045)	(140,179)
Cash Provided from (Used for) Financing Transactions			
Net increase (decrease) in long-term debt	100,623	(15,067)	(2,754)
Net increase (decrease) in short-term debt	(1,223)	2,853	799
Purchase of the Corporation's Common Stock	(86,904)	—	—
Cash provided from (used for) financing transactions	12,496	(12,214)	(1,955)
Increase (Decrease) in Cash and Short-Term Investments	(83,030)	22,719	14,826
Cash and Short-Term Investments at January 1	110,636	87,917	73,091
Cash and Short-Term Investments at December 31	$ 27,606	$ 110,636	$ 87,917

The notes to consolidated financial statements are an integral part of these statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands of dollars)

	Common Stock	Class B Common Stock	Additional Paid-In Capital	Cumulative Foreign Currency Translation Adjustments	Retained Earnings	Total Stockholders' Equity
Balance at January 1, 1984	$31,337	$ —	$54,006	$(2,154)	$512,848	$596,037
Net income					108,682	108,682
Dividends—Common Stock (Note 2)					(37,073)	(37,073)
Dividends—Class B Common Stock (Note 2)					(1,607)	(1,607)
Foreign currency translation adjustments (Note 1)				(1,721)		(1,721)
Exchange of Common Stock (Note 2)	(5,102)	5,102				—
Adoption of equity method of accounting for AB Marabou (Note 3)				(3,390)		(3,390)
Balance at December 31, 1984	26,235	5,102	54,006	(7,265)	582,850	660,928
Net income					112,227	112,227
Dividends—Common Stock (Note 2)					(37,385)	(37,385)
Dividends—Class B Common Stock (Note 2)					(6,557)	(6,557)
Foreign currency translation adjustments (Note 1)				(1,314)		(1,314)
Conversion of Class B Common Stock into Common Stock (Note 2)	1	(1)				—
Balance at December 31, 1985	26,236	5,101	54,006	(8,579)	651,135	727,899
Net income					132,764	132,764
Dividends—Common Stock (Note 2)					(40,929)	(40,929)
Dividends—Class B Common Stock (Note 2)					(7,217)	(7,217)
Foreign currency translation adjustments (Note 1)				2,456		2,456
Conversion of Class B Common Stock into Common Stock (Note 2)	1	(1)				—
Three-for-one stock split (Note 2)	52,474	10,200			(62,674)	—
Purchase and Retirement of Common Stock (Note 2)	(3,825)		(2,197)		(80,882)	(86,904)
Incentive plan distribution			(128)			(128)
Balance at December 31, 1986	$74,886	$15,300	$51,681	$(6,123)	$592,197	$727,941

The notes to consolidated financial statements are an integral part of these statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies employed by the Corporation are discussed below and in Notes 7 and 8. As described in Note 3, Cory Food Services, Inc. and Cory Canada Inc. were sold in November 1985. Accordingly, 1984 amounts have been restated to reflect discontinued operations.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its subsidiaries after elimination of intercompany accounts and transactions.

Investments

Short-term investments are stated at the lower of cost or market. Investments in affiliated companies accounted for on the equity method are included in "Investments and Other Assets."

Commodities Futures Contracts

In connection with the procurement of major commodities, principally cocoa and sugar, the Corporation enters into commodities futures contracts as deemed appropriate to reduce its exposure to future price increases for anticipated manufacturing requirements. Gains and losses on such futures contracts are deferred and recognized in cost of sales when the related product is manufactured and sold.

Foreign Currency Translation

For foreign entities, assets and liabilities are translated to U.S. dollars using the exchange rates in effect at the balance sheet date. Results of operations are translated using the average exchange rates during the period. Resulting translation adjustments are recorded in a separate component of stockholders' equity, "Cumulative Foreign Currency Translation Adjustments." For foreign entities operating in highly inflationary economies, non-monetary assets and liabilities are translated at historical exchange rates and related translation gains and losses are included in results of operations. Foreign exchange gains and losses included in the consolidated statements of income were not material.

Inventories

Substantially all of the Chocolate and Confectionery and certain Other Food Products inventories are valued under the last-in, first-out (LIFO) method at amounts that do not exceed realizable values. The remaining inventories are stated at the lower of first-in, first-out (FIFO) cost or market. The LIFO cost of inventories valued using the LIFO method was $172,685,000 in 1986 and $139,717,000 in 1985. Total year-end inventories were as follows:

December 31,	1986	1985
(in thousands of dollars)		
Raw materials	**$171,160**	$126,879
Goods in process	**30,575**	26,936
Finished goods	**131,673**	126,786
Inventories at FIFO	**333,408**	280,601
Adjustment to LIFO	**(95,899)**	(87,923)
Total inventories	**$237,509**	$192,678

Property, Plant and Equipment

Depreciation and amortization of buildings, machinery and equipment, and capitalized leases are computed using the straight-line method. Property, plant and equipment balances include construction in progress in the amount of $45,554,000 at December 31, 1986 and $27,756,000 at December 31, 1985.

Intangibles Resulting from Business Acquisitions

Intangible assets resulting from business acquisitions principally consist of the excess of the acquisition cost over the fair value of the net assets of businesses acquired (goodwill). Goodwill is amortized on a straight-line basis over periods not exceeding 40 years. The increase during 1986 was primarily the result of the acquisition of The Dietrich Corporation.

Other intangible assets are amortized on a straight-line basis over their estimated useful lives.

Promotion and Development Expenses

The costs of advertising and promotion ($218,148,000 in 1986, $193,036,000 in 1985 and $176,891,000 in 1984) and research and development ($13,225,000 in 1986, $11,181,000 in 1985 and $9,932,000 in 1984) are expensed in the year incurred.

Interest Expense

Interest expense, net consisted of the following:

For the years ended December 31,	1986	1985	1984
(in thousands of dollars)			
Long-term debt	**$10,303**	$ 9,883	$10,339
Capitalized leases	**3,046**	2,908	2,639
Short-term debt	**3,314**	8,277	3,573
Capitalized interest	**(3,642)**	(2,520)	(1,260)
	13,021	18,548	15,291
Interest income	**(3,222)**	(6,619)	(4,942)
	$ 9,799	$11,929	$10,349

2. CAPITAL STOCK

On November 14, 1986, Hershey Trust Company, as Trustee for Milton Hershey School (Hershey Trust), sold 5,175,000 shares of the Corporation's Common Stock in an underwritten secondary public offering. On the same date, the Corporation purchased from Hershey Trust 3,825,000 shares of Common Stock for $86,904,000 representing $22.72 per share, a price equal to the proceeds per share to Hershey Trust in the secondary public offering. Immediately thereafter, the shares acquired by the Corporation were retired and became authorized but unissued shares of Common Stock.

As of December 31, 1986 and 1985, the authorized number of shares of capital stock was 230,000,000. Of this amount, 150,000,000 shares were designated as Common Stock, 75,000,000 shares as Class B Common Stock (Class B Stock), and 5,000,000 shares as Preferred Stock, each class having a par value of one dollar per share.

In general terms, the Common Stock has greater dividend rights, but lesser voting power, than the Class B Stock. The Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having 10 votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

Shares of the Class B Stock were issued in a one-time-only exchange offer to Common Stock holders on a share-for-share basis in late 1984. Class B Stock can be converted into Common Stock on a share-for-share basis at any time. During 1986, 4,320 shares of Class B stock were converted into Common Stock, and during 1985, 1,800 shares of Class B Stock were converted into Common Stock (number of shares adjusted for the three-for-one stock split effective September 15, 1986). At December 31, 1986, there was a combined total of 90,186,336 shares of both classes outstanding. No shares of the Preferred Stock were issued or outstanding. Hershey Trust Company, as Trustee for Milton Hershey School, as institutional fiduciary for estates and trusts unrelated to Milton Hershey School, and as direct owner of investment shares, held a total of 23,423,547 shares of the Common Stock, and, as trustee for Milton Hershey School, held 15,153,003 shares of the Class B Stock at December 31, 1986, and is entitled to cast approximately 77% of the total votes of both classes of the Corporation's common stock.

Net income per share has been computed based on the weighted average number of shares of the Common Stock and the Class B Stock outstanding during the year (93,508,322 in 1986, 94,011,336 in 1985 and 1984) as adjusted for the three-for-one stock split effective September 15, 1986 and the purchase of Common Stock shares on November 14, 1986. Dividends paid per share have also been adjusted for the three-for-one stock split.

3. ACQUISITIONS AND DIVESTITURES

On October 27, 1986, the Corporation acquired The Dietrich Corporation by the purchase of its outstanding shares of capital stock for approximately $100 million plus an amount equal to acquired cash and short-term investments. The acquired operations consist of Luden's, maker of LUDEN'S cough drops, 5TH AVENUE candy bar and LUDEN'S MELLOMINTS candies, and Queen Anne, a producer of chocolate covered cherries.

In 1986, the Corporation purchased the stock of Idlenot Farm Restaurants, Inc., a chain of 12 restaurants located in Vermont, New Hampshire and New York, and Litchfield Farm Shops, Inc., a chain of 23 restaurants in Connecticut. These acquisitions were made in July and December, respectively. In September 1985, the Corporation purchased the stock of Marvin Franklin Enterprises, Inc., a chain of 12 restaurants located in Pennsylvania.

In October 1986, the Corporation sold its 22½% interest in Chadler Industrial de Bahia S.A., a cocoa bean processor located in Salvador, Bahia, Brazil. The sales price approximated the Corporation's investment.

In December 1986, the Corporation formed a joint venture in Brazil with the Bunge Born Group. Under the joint venture agreement, a Brazilian pasta unit of the Bunge Born Group was combined with Petybon. Petybon, a producer of pasta, biscuit and margarine products, was a 100% owned subsidiary of the Corporation prior to the joint venture agreement. The Corporation retained a 45% equity interest in the joint venture. Accordingly, the Corporation adopted the equity method of accounting effective December 1986.

In November 1985, the Corporation sold the stock of Cory Food Services, Inc. and Cory Canada Inc., wholly-owned subsidiaries of the Corporation. The 1985 after-tax loss from discontinued operations of $8.4 million ($.09 per share) includes both 1985 operating losses and the loss on disposal. The 1984 after-tax loss from discontinued operations of $1.8 million ($.01 per share) represents operating losses. Per share amounts reflect the three-for-one stock split.

In November 1984, the Corporation purchased the inventory, buildings, land, machinery and equipment, trademarks and certain other intangible assets of American Beauty (a division of The Pillsbury Company) for approximately $56.0 million, and assumed certain liabilities.

In mid-1984, the Corporation purchased an additional interest in AB Marabou, a confectionery company in Sweden, thereby increasing the Corporation's ownership interest from 17% to 20%. Accordingly, the Corporation adopted the equity method of accounting for Marabou's results of operations during 1984.

The above acquisitions were accounted for as purchases, and accordingly, results subsequent to the dates of acquisition are included in the consolidated financial statements. Had the results of these acquisitions been included in consolidated results for the entire period 1984 through 1986, the effect would not have been material.

4. SHORT-TERM DEBT

The Corporation maintained lines of credit arrangements with commercial banks, under which it could borrow up to $100 million in 1986 and 1985 at the lending banks' prime commercial interest rates or lower. These lines of credit, which may be used to support commercial paper borrowings, may be terminated at the option of the banks or the Corporation. There were no borrowings under these lines of credit at December 31, 1986 or 1985.

Lines of credit are supported by commitment fee and/or compensating balance arrangements. The fees range up to ¼% per annum of the commitment. While there are no compensating balance agreements which legally restrict these funds, the Corporation generally maintains balances of up to 3¾% but not less than 2% of commitments under these lines of credit.

The average outstanding balance of short-term debt was $12,713,000 in 1986 and $5,901,000 in 1985. The 1986 average reflects foreign borrowings in Brazil and domestic borrowings under both lines of credit and commercial paper. Domestic borrowings were used to fund seasonal working capital requirements and provide interim financing for the acquisition of The Dietrich Corporation and purchase of 3,825,000 shares of the Corporation's Common Stock. The 1985 average balance related solely to borrowings in Brazil. Maximum short-term borrowings at any month-end were $109,710,000 and $10,182,000 in 1986 and 1985, respectively.

As a result of maintaining a consolidated cash management system, the Corporation maintains overdraft positions at certain banks. Such overdrafts, which are included in accounts payable, were $23,747,000 and $14,421,000 at December 31, 1986 and 1985, respectively.

5. LONG-TERM DEBT

Long-term debt and capitalized lease obligations at December 31, 1986 and 1985 consisted of the following:

	1986	1985
(in thousands of dollars)		
7.0% Notes due 1989	**$ 50,000**	$ —
8.7% Senior Notes due 1992	**12,000**	14,000
7.25% Sinking Fund Debentures due 1997	**1,023**	1,023
6.875% Industrial Revenue Bonds due 2000–2005	**4,000**	4,000
10.4% Industrial Revenue Bonds due 2002	**1,000**	1,000
9.5% Sinking Fund Debentures due 2009	**63,000**	63,000
10.625% Pollution Control Revenue Bonds due 2012	**2,100**	2,100
9.125% Sinking Fund Debentures due 2016	**50,000**	—
Other obligations, net	**8,696**	2,977
Capitalized lease obligations	**27,373**	26,877
	219,192	114,977
Less—current portion	**8,400**	4,808
Total long-term debt	**$210,792**	$110,169

On April 18, 1986, pursuant to Rule 415 of the Securities Act of 1933, as amended, the Corporation filed a registration statement with the Securities and Exchange Commission registering $200,000,000 aggregate principal amount of unsecured, unsubordinated Debt Securities. The Debt Securities may be offered from time to time. Terms are to be determined at the time the debt is offered.

On November 25, 1986, the Corporation issued $50,000,000 of 7% Notes due in 1989 and $50,000,000 of 9⅛% Sinking Fund Debentures due in 2016. The proceeds were used to substantially repay short-term borrowings incurred to finance the acquisition of The Dietrich Corporation and the purchase of 3,825,000 shares of the Corporation's Common Stock. After the issuance, $100,000,000 aggregate principal amount of Debt Securities remained available for issuance under the registration statement filed on April 18, 1986.

In 1985, the Corporation repurchased $14,427,000 of sinking fund debentures to be used to meet future minimum annual payments.

Aggregate annual maturities and sinking fund requirements, net of repurchased debentures and exclusive of capitalized lease obligations, are: 1987, $5,663,000; 1988, $2,578,000; 1989, $55,648,000; 1990, $5,700,000; 1991, $5,754,000.

6. LEASES

Total rent expense for all operating leases, which pertain principally to certain administrative buildings, distribution facilities, restaurants and transportation equipment, was $23,799,000 in 1986, $22,039,000 in 1985 and $19,637,000 in 1984.

Future minimum lease payments under noncancelable leases with an original term in excess of one year as of December 31, 1986 are shown in the following table.

	Operating Leases	Capital Leases
(in thousands of dollars)		
1987	$ 10,192	$ 5,989
1988	9,391	5,616
1989	10,889	4,322
1990	10,268	3,976
1991	9,537	3,871
1992 and beyond	172,367	26,264
Total minimum lease payments	$222,644	$ 50,038

The total minimum lease payments under capital leases include $22,665,000 of imputed interest. Capital leases primarily pertain to restaurant facilities and data processing equipment.

7. INCOME TAXES

The provision for Federal and state income taxes is based on income from continuing operations before income taxes as reported in the financial statements. Income tax benefits relating to discontinued operations in 1985 and 1984 are included in the "Loss from Discontinued Operations" in the Consolidated Statements of Income. Investment and other tax credits are recognized as a reduction in the provision using the flow-through method. Investment tax credits for 1986 reflect the Tax Reform Act of 1986 (1986 Tax Act) which retroactively eliminated investment tax credits for capital investments initiated subsequent to December 31, 1985. The primary effect of the 1986 Tax Act was to eliminate approximately $3.6 million in investment tax credits for 1986. The resulting increase in the effective income tax rate was recorded in the fourth quarter of 1986 in accordance with the Financial Accounting Standards Board Technical Bulletin, "Accounting for Certain Effects of the Tax Reform Act of 1986."

Deferred income taxes are provided to reflect timing differences between reported results of operations for financial statement and income tax purposes. Timing differences relate primarily to accelerated depreciation, employee benefit plan contributions and deferred gains on sale and leaseback transactions. Such gains were taxable in a prior year but are amortized over lease terms for financial statement purposes. The provision for income taxes on income from continuing operations was as follows:

For the years ended December 31,	1986	1985	1984
(in thousands of dollars)			
Current	**$101,581**	$ 81,996	$ 79,604
Deferred	**26,488**	30,268	22,454
Provision for income taxes	**$128,069**	$112,264	$102,058

The following table reconciles the provision for income taxes with the amount computed by applying the Federal statutory rate:

For the years ended December 31,	1986		1985		1984	
(in thousands of dollars)	**Amount**	%	Amount	%	Amount	%
Income taxes computed at statutory rate	**$119,983**	**46.0**	$107,140	46.0	$ 97,747	46.0
Increase (reduction) resulting from:						
State income taxes, net of Federal income tax benefits	**11,522**	**4.4**	10,857	4.7	10,073	4.7
Investment tax credit	**(2,489)**	**(.9)**	(5,348)	(2.3)	(4,618)	(2.2)
Nondeductible acquisition costs	**1,835**	**.7**	1,718	.7	1,583	.7
Payroll tax credits and other	**(2,782)**	**(1.1)**	(2,103)	(.9)	(2,727)	(1.2)
Provision for income taxes	**$128,069**	**49.1**	$112,264	48.2	$102,058	48.0

8. RETIREMENT PLANS AND OTHER RETIREE BENEFITS

The Corporation and its subsidiaries sponsor a number of defined benefit retirement plans covering substantially all employees. Plans covering salaried employees provide retirement benefits based on career average or final pay compensation as defined within the provisions of the individual plans, while plans covering hourly employees generally provide benefits based on years of service. The Corporation's policy is to fund the normal cost plus amounts required to amortize actuarial gains and losses and prior service costs over periods ranging from 15 to 30 years. Plan assets are invested in a broadly diversified portfolio consisting primarily of domestic and international common stocks and fixed income securities. The Corporation also participates in several multiemployer retirement plans which provide defined benefits to employees covered under certain collective bargaining agreements.

In the fourth quarter of 1986, the Corporation adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (FAS No. 87), for all domestic retirement plans, retroactive to January 1, 1986. Pension expense for the Canadian plan in 1986 and for all plans in 1985 and 1984 was determined using provisions of previous accounting principles. In accordance with the provisions of FAS No. 87, pension expense for 1985 and 1984 has not been restated. Pension expense for the first three quarters of 1986 was not restated as the effects would not have been material.

Pension expense for 1986 is not directly comparable with 1985 and 1984 because of the significant changes in accounting for pension expense under FAS No. 87. If FAS No. 87 had not been adopted for domestic plans in 1986, pension expense for 1986 would have been higher than 1985, primarily due to benefit improvements in certain salary and hourly plans. The pension expense decrease under FAS No. 87 reflects revised salary increase assumptions recognizing the outlook for lower inflation, updated discount rates and investment return rates based upon expectations of long-term rates of return.

The following is a summary of consolidated pension expense for the year ended December 31, 1986 (in thousands of dollars):

Corporate sponsored domestic pension plans, prior to application of FAS 87	$14,703
Effect of adopting FAS 87	(7,270)
Corporate sponsored domestic pension plans	7,433
Multiemployer plans	558
Canadian pension plan	221
Other	355
Total pension expense	$ 8,567

Pension expense for the years ended December 31, 1985 and 1984 was $13,810,000 and $13,542,000, respectively.

For the year ended December 31, 1986, pension expense for the domestic plans sponsored by the Corporation included the following components (in thousands of dollars):

Service cost (benefits earned during the period)	$ 9,758
Interest cost on projected benefit obligation	16,689
Investment return on plan assets	(31,514)
Net amortization and deferral	12,500
Corporate sponsored domestic pension plans	$ 7,433

The projected benefit obligation for the domestic plans was determined using an assumed discount rate of 8.5% and an assumed long-term compensation increase rate of principally 6%. The assumed long-term rate of return on plan assets was 9.5%.

The following table sets forth the funded status and amounts recognized in the consolidated balance sheet at December 31, 1986 for the domestic plans sponsored by the Corporation:

(in thousands of dollars)	Assets Exceed Accumulated Benefits	Accumulated Benefits Exceed Assets
Actuarial present value of:		
Vested benefit obligation	$162,521	$ 4,101
Accumulated benefit obligation	$173,498	$ 5,272
Projected benefit obligation	$210,123	$ 9,154
Plan assets at fair value	237,670	—
Plan assets greater than (less than) the projected benefit obligation	27,547	(9,154)
Unrecognized net (gain) loss at January 1, 1986	(6,862)	5,890
Unrecognized net (gain) loss during the year	(12,784)	(75)
Prepaid pension expense (pension liability) at December 31, 1986	$ 7,901	$(3,339)

The actuarial present value of consolidated accumulated benefits for the Corporate sponsored domestic pension plans at December 31, 1985 was $168,476,000 (of which $8,307,000 was nonvested), compared with market value of net assets available for benefits of $199,461,000.

8. RETIREMENT PLANS AND OTHER RETIREE BENEFITS *(continued)*

The assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8%.

Retirement benefits provided to employees in Canada are based on local practice and are administered through a separate plan. In accordance with transition provisions, the Corporation has not adopted FAS No. 87 for this plan. The actuarial present value of accumulated benefits for this plan at April 1, 1986 was $2,535,000 (of which $186,000 was nonvested), compared with net assets available for benefits of $4,661,000. The assumed average rate of return used in determining the actuarial present value of benefits was 7.5%.

The Corporation and its subsidiaries provide certain health care and life insurance benefits for retired employees. Substantially all of the Corporation's domestic employees become eligible for these benefits at normal retirement age. Retiree health care and life insurance premiums of $2,250,000, $2,027,000 and $1,760,000 were expensed as paid during 1986, 1985, and 1984, respectively.

9. QUARTERLY DATA (Unaudited)

The following is a summary of quarterly data for the years 1986 and 1985. Per share data has been restated to reflect the three-for-one stock split effective September 15, 1986:

(in thousands of dollars except shares and per share amounts)

Year 1986	First	Second	Third	Fourth	Year
Net sales	$507,996	$450,201	$596,446	$614,971	$2,169,614
Gross profit	163,721	148,760	197,601	206,092	716,174
Net income	27,011	24,577	43,539	37,637	132,764
Net income per share	.29	.26	.46	.41	1.42

Year 1985	First	Second	Third	Fourth	Year
Net sales	$476,505	$431,074	$547,724	$540,851	$1,996,154
Gross profit	147,600	135,839	176,522	180,404	640,365
Income from continuing operations	22,962	22,578	39,532	35,577	120,649
(Loss) from discontinued operations	(224)	(504)	(7,694)	—	(8,422)
Net income	22,738	22,074	31,838	35,577	112,227
Income from continuing operations per share	.24	.25	.42	.37	1.28
Net income per share	.24	.24	.34	.37	1.19

The weighted average number of shares outstanding was 94,011,336 for all periods indicated except for the fourth quarter of 1986 and the year 1986 for which shares outstanding were 92,058,144 and 93,508,322, respectively.

10. INDUSTRY SEGMENT

Industry segment information is shown on pages 20 through 23.

RESPONSIBILITY FOR FINANCIAL STATEMENTS

Hershey Foods Corporation is responsible for the financial statements and other financial information contained in this report. The Corporation believes that the financial statements have been prepared in conformity with generally accepted accounting principles appropriate under the circumstances to reflect in all material respects the substance of applicable events and transactions. In preparing the financial statements, it is necessary that management make informed estimates and judgments. The other financial information in this annual report is consistent with the financial statements.

The Corporation maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. The concept of reasonable assurance is based on the recognition that the cost of the system must be related to the benefits to be derived. The Corporation believes its system provides an appropriate balance in this regard. The Corporation maintains an Internal Auditing Department which reviews the adequacy and tests the application of internal accounting controls.

The financial statements have been examined by Arthur Andersen & Co., independent public accountants, whose appointment was ratified by stockholder vote at the stockholders' meeting held on April 28, 1986. Their report expresses an opinion that the Corporation's financial statements are fairly stated in conformity with generally accepted accounting principles, and they have indicated to us that their examination was performed in accordance with generally accepted auditing standards and, accordingly, included reviewing the internal accounting controls and conducting other auditing procedures they deemed necessary.

The Audit Committee of the Board of Directors of the Corporation, consisting solely of outside directors, meets regularly with the independent public accountants, internal auditors and management to discuss, among other things, the audit scopes and results. Arthur Andersen & Co. and the internal auditors both have full and free access to the Audit Committee, with and without the presence of management.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors
of Hershey Foods Corporation:

We have examined the consolidated balance sheets of Hershey Foods Corporation (a Delaware Corporation) and subsidiaries as of December 31, 1986 and 1985 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1986 and 1985 and the results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1986 in conformity with generally accepted accounting principles applied on a consistent basis.

New York, N.Y.
February 6, 1987

Arthur Andersen & Co.

HERSHEY FOODS CORPORATION

SIX-YEAR CONSOLIDATED FINANCIAL SUMMARY

(all dollars and shares amounts in thousands except market price and per share statistics)

	1986	1985	1984	1983	1982	1981
Summary of Earnings[a]						
Net Sales	$2,169,614	1,996,154	1,848,492	1,662,663	1,565,736	1,451,151
Cost of Sales	$1,453,440	1,355,789	1,269,801	1,145,867	1,084,748	1,015,767
Selling, General and Administrative	$ 445,542	395,523	355,849	310,115	301,586	267,930
Interest Expense, net	$ 9,799	11,929	10,349	15,814	7,859	12,512
Income Taxes	$ 128,069	112,264	102,058	89,895	77,375	74,580
Income from Continuing Operations	$ 132,764	120,649	110,435	100,972	94,168	80,362
(Loss) from Discontinued Operations	$ —	(8,422)	(1,753)	(806)	—	—
Net Income	$ 132,764	112,227	108,682	100,166	94,168	80,362
Income Per Share from Continuing Operations	$ 1.42	1.28	1.17	1.07	1.00	.94
Net Income Per Share	$ 1.42	1.19	1.16	1.07	1.00	.94
Dividends Paid Per Share of Common Stock	$ .520	.475	.413	.367	.333	.292
Dividends Paid Per Share of Class B Common Stock	$ .472	.428	.105	—	—	—
Weighted Average Number of Shares of Common Stock and Class B Common Stock Outstanding During the Year	93,508	94,011	94,011	94,011	94,011	85,930
Income from Continuing Operations as a Percentage of Net Sales	6.1%	6.0%	6.0%	6.1%	6.0%	5.5%
Financial Statistics						
Capital Additions	$ 135,828	114,449	87,049	105,244	116,736	91,673
Depreciation[a]	$ 55,987	49,644	41,322	35,570	30,681	27,565
Advertising[a]	$ 91,236	83,835	78,570	68,374	64,046	56,516
Current Assets	$ 393,420	412,290	385,321	336,605	291,628	309,677
Current Liabilities	$ 222,143	195,322	202,953	151,634	148,893	134,035
Working Capital	$ 171,277	216,968	182,368	184,971	142,735	175,642
Current Ratio	1.8:1	2.1:1	1.9:1	2.2:1	2.0:1	2.3:1
Long-Term Debt	$ 210,792	110,169	125,236	127,990	140,250	158,182
Capitalization Ratio	23%	14%	17%	18%	23%	25%
Stockholders' Equity	$ 727,941	727,899	660,928	596,037	532,495	469,664
Total Assets	$1,356,303	1,197,432	1,122,567	983,944	904,754	829,447
Return on Average Stockholders' Equity	18.2%	16.2%	17.3%	17.8%	18.8%	19.3%
After-Tax Return on Average Invested Capital	13.5%	12.7%	13.5%	13.8%	14.3%	13.9%
Stockholders' Data						
Outstanding Shares of Common Stock and Class B Common Stock at Year-End	90,186	94,011	94,011	94,011	94,011	94,011
Market Price of Common Stock At Year-End	$ 24⅝	17⅛	12⅞	10½	9⅝	6
Range During Year	$ 30–15½	18⅜–11⅝	13¾–9⅜	11⅝–8⅛	9⅞–5⅜	6⅞–3⅞
Number of Common Stock and Class B Common Stock Holders At Year-End	23,502	17,529	16,729	16,467	16,033	16,817
Employee Data[a]						
Payrolls	$ 430,792	391,781	354,422	326,615	305,651	273,097
Full-Time Employees at Year-End	15,980	15,240	14,410	13,510	13,600	12,450

Notes:

(a) Amounts for 1984 and 1983 have been restated for discontinued operations. Amounts for 1982 and 1981 have not been restated to reflect discontinued operations due to immateriality.

(b) All shares and per share amounts have been adjusted for the two-for-one stock split effective September 15, 1983 and the three-for-one stock split effective September 15, 1986.

(c) Financial statistics include certain reclassifications which have been made to the December 31, 1982 and 1981 consolidated financial statements.

DIRECTORS AND SENIOR MANAGEMENT

As of March 1, 1987

BOARD OF DIRECTORS

Richard A. Zimmerman
Chairman of the Board
and Chief Executive Officer

Richard T. Baker
Consultant, Ernst & Whinney
certified public accountants
Delray Beach, Fla.

Howard O. Beaver, Jr.
Retired Chairman of the Board
Carpenter Technology Corporation
Reading, Pa.

Edward R. Book
Chairman of the Board
and Chief Executive Officer
Hershey Entertainment & Resort Company
(HERCO Inc.)
Hershey, Pa.

John F. Burlingame
Retired Vice Chairman of the Board
and Executive Officer
General Electric Company
Stamford, Conn.

John C. Jamison
Dean, School of Business Administration
The College of William & Mary
Williamsburg, Va.

Dr. Ogden C. Johnson
Senior Vice President

Dr. Sybil C. Mobley
Dean, School of Business and Industry
Florida Agricultural and
Mechanical University
Tallahassee, Fla.

Francine I. Neff
Vice President and Director
NETS Inc.
privately-held investment company
Albuquerque, N.M.

H. Robert Sharbaugh
Retired Chairman
and Chief Executive Officer
Sun Company, Inc.
Hilton Head Island, S.C.

Joseph P. Viviano
President
Hershey Chocolate Company

Kenneth L. Wolfe
President and Chief Operating Officer

AUDIT COMMITTEE

Richard T. Baker, *Chairman*
John F. Burlingame
Dr. Sybil C. Mobley
Francine I. Neff

COMPENSATION AND EXECUTIVE ORGANIZATION COMMITTEE

H. Robert Sharbaugh, *Chairman*
Howard O. Beaver, Jr.
John F. Burlingame
John C. Jamison

EMPLOYEE BENEFIT COMMITTEE

John C. Jamison, *Chairman*
Howard O. Beaver, Jr.
Edward R. Book
Dr. Sybil C. Mobley
H. Robert Sharbaugh

EXECUTIVE COMMITTEE

Richard A. Zimmerman, *Chairman*
Dr. Ogden C. Johnson
Joseph P. Viviano
Kenneth L. Wolfe

NOMINATING COMMITTEE

Francine I. Neff, *Chairperson*
Richard T. Baker
Edward R. Book
Richard A. Zimmerman

DIVISION PRESIDENTS

John F. Cauley, Jr.
President
Friendly Ice Cream Corporation

David B. Conn
President
Hershey Canada Inc.

Richard M. Marcks
President
Hershey International Ltd.

C. Mickey Skinner
President
Hershey Pasta Group

Joseph P. Viviano
President
Hershey Chocolate Company

CORPORATE OFFICERS

Richard A. Zimmerman
Chairman of the Board and
Chief Executive Officer

Kenneth L. Wolfe
President and
Chief Operating Officer

Dr. Ogden C. Johnson
Senior Vice President

Kenneth L. Bowers
Vice President
Corporate Communications

Charles E. Duroni
Vice President and
General Counsel

William Lehr, Jr.
Vice President and
Secretary

William P. Noyes
Vice President
Human Resources

Michael F. Pasquale
Vice President, Finance and
Chief Financial Officer

William F. Suhring
Vice President
Corporate Development

Dr. Barry L. Zoumas
Vice President
Science and Technology

Thomas C. Fitzgerald
Treasurer

Howard W. Rush, Jr.
Controller and
Chief Accounting Officer

Hershey Foods Corporation
Hershey, Pennsylvania 17033, U.S.A.